SEC FORM – I-ACGR

INTEGRATED ANNUAL CORPORATE GOVERNANCE REPORT

GENERAL INSTRUCTIONS

A. Use of Form I-ACGR

This SEC Form shall be used as a tool to disclose Publicly-Listed Companies' compliance/non-compliance with the recommendations provided under the Code of Corporate Governance for Publicly-Listed Companies, which follows the "comply or explain" approach, and for harmonizing the corporate governance reportorial requirements of the SEC and the Philippine Stock Exchange (PSE).

B. Preparation of Report

These general instructions are not to be filed with the report. The report shall contain the numbers and captions of all items.

The I-ACGR has four columns, arranged as follows:

RECOMMENDED CG PRACTICE/POLICY	COMPLIANT/ NON-COMPLIANT	ADDITIONAL INFORMATION	EXPLANATION
Contains CG Practices/ Policies, labelled as follows: (1) **"Recommendations"** – derived from the CG Code for PLCs; (2) **"Supplement to Recommendation"** – derived from the PSE CG Guidelines for Listed Companies; (3) **"Additional Recommendations"** – CG Practices not found in the CG Code for PLCs and PSE CG Guidelines but are expected already of PLCs; and (4) **"Optional Recommendation"** – practices taken from the ASEAN Corporate Governance Scorecard ***Items under (1) – (3) must be answered/disclosed by the PLCs following the "comply or explain" approach. Answering of items under (4) are left to the discretion of PLCs.**	The company shall **indicate compliance or non-compliance** with the recommended practice.	The company shall provide additional information to **support their compliance** with the recommended CG practice	The PLCs shall **provide the explanations for any non-compliance,** pursuant to the "comply or explain" approach. Please note that the explanation given should describe the non-compliance and include **how the overall Principle being recommended is still being achieved** by the company. ***"Not Applicable" or "None" shall not be considered as sufficient explanation**

C. Signature and Filing of the Report

a. Three (3) copies of a fully accomplished I-ACGR shall be filed with the Main Office of the Commission **on or before May 30 of the following year for every year that the company remains listed in the PSE;**

b. At least one (1) complete copy of the I-ACGR shall be duly notarized and shall bear **original and manual** signatures

c. The I-ACGR shall be signed under oath by: (1) Chairman of the Board; (2) Chief Executive Officer or President; (3) All Independent Directors; (4) Compliance Officer; and (5) Corporate Secretary.

d. The I-ACGR shall cover all relevant information from January to December of the given year.

e. All reports shall comply with the full disclosure requirements of the Securities Regulation Code.

SEC FORM – I-ACGR

INTEGRATED ANNUAL CORPORATE GOVERNANCE REPORT

1. For the fiscal year ended **December 31, 2017**

2. SEC Identification Number **A-1997-9587** 3. BIR Tax Identification No. **005-338-421-000**

4. Exact name of issuer as specified in its charter **CITYSTATE SAVINGS BANK, INC.**

5. **Makati City, Metro Manila, Philippines**
Province, Country or other jurisdiction of incorporation or organization

6. (SEC Use Only)
Industry Classification Code:

7. **Citystate Centre Building, 709 Shaw Boulevard, Pasig City** **1600**
Address of principal office Postal Code

8. **(632) 470-3333**
Issuer's telephone number, including area code

9. **N/A**
Former name, former address, and former fiscal year, if changed since last report.

INTEGRATED ANNUAL CORPORATE GOVERNANCE REPORT			
	COMPLIANT/ NON-COMPLIANT	**ADDITIONAL INFORMATION**	**EXPLANATION**
The Board's Governance Responsibilities			
Principle 1: The company should be headed by a competent, working board to foster the long- term success of the corporation, and to sustain its competitiveness and profitability in a manner consistent with its corporate objectives and the long- term best interests of its shareholders and other stakeholders.			
Recommendation 1.1			
1. Board is composed of directors with collective working knowledge, experience or expertise that is relevant to the company's industry/sector.	**Compliant**	• Annual Report for the year 2017 (SEC 17-A) • CSBI Website (www.citystatesavings.com) • Information Statement (Preliminary and Definitive) • Manual on Corporate Governance	
2. Board has an appropriate mix of competence and expertise.	**Compliant**		
3. Directors remain qualified for their positions individually and collectively to enable them to fulfill their roles and responsibilities and respond to the needs of the organization.	**Compliant**		
Recommendation 1.2			
1. Board is composed of a majority of non-executive directors.	**Compliant**	• Annual Report for the year 2017 (SEC 17-A) • CSBI Website (www.citystatesavings.com) • Information Statement (Preliminary and Definitive)	
Recommendation 1.3			
1. Company provides in its Board Charter and Manual on Corporate Governance a policy on training of directors.	**Compliant**	• Manual on Corporate Governance (www.citystatesavings.com). • Disclosure on Corporate Governance Seminar dated December 28, 2017 (Annex A).	

2. Company has an orientation program for first time directors.	**Compliant**	• Manual on Corporate Governance (www.citystatesavings.com). • Disclosure on Corporate Governance Seminar dated December 28, 2017 (Annex A).	
3. Company has relevant annual continuing training for all directors.	**Compliant**		
Recommendation 1.4			
1. Board has a policy on board diversity.	**Compliant**	• Manual on Corporate Governance (www.citystatesavings.com). • Annual Report for the year 2017 (SEC 17-A) • Information Statement (Preliminary and Definitive) As of December 31, 2017, the Board of Director's composed of twelve (12) males and one (1) female, each of whom has diverse educational, business and professional backgrounds.	
Optional: Recommendation 1.4			
1. Company has a policy on and discloses measurable objectives for implementing its board diversity and reports on progress in achieving its objectives.			
Recommendation 1.5			
1. Board is assisted by a Corporate Secretary.	**Compliant**	The Corporate Secretary assists in setting the Board agenda and performs the following: 1. Provides ready and reasonable information that the Directors may need during deliberation in board issues. 2. Maintains the reliability of the	

2. Corporate Secretary is a separate individual from the Compliance Officer.	**Compliant**	Minutes of Board Meetings. 3. Updates to the Directors and Management about regulatory changes. Our Corporate Secretary, Atty. Socrates M. Arevalo, possesses the qualification and competencies to effectively perform his duties. • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B). • CSBI Website (www.citystatesavings.com)	
3. Corporate Secretary is not a member of the Board of Directors.	**Compliant**		
4. Corporate Secretary attends training/s on corporate governance.	**Compliant**	Disclosure on Corporate Governance Seminar dated December 28, 2017 (Annex A).	
Optional: Recommendation 1.5			
1. Corporate Secretary distributes materials for board meetings at least five business days before scheduled meeting.			
Recommendation 1.6			
1. Board is assisted by a Compliance Officer.	**Compliant**	Ms. Irish Janne B. Escio, Vice President/Chief Compliance Officer, provides full support to the Board and Board Committees in their oversight duties. The Chief Compliance Officer is not a member of the board. • Disclosure on the result of the Annual Stockholder's Meeting, May	
2. Compliance Officer has a rank of Senior Vice President or an equivalent position with adequate stature and authority in the corporation.	**Compliant**		

3. Compliance Officer is not a member of the board.	**Compliant**	30, 2017 (Annex B). • CSBI Website (www.citystatesavings.com)	
4. Compliance Officer attends training/s on corporate governance.	**Compliant**	Disclosure on Corporate Governance Seminar dated December 28, 2017 (Annex A).	
Principle 2: The fiduciary roles, responsibilities and accountabilities of the Board as provided under the law, the company's articles and by-laws, and other legal pronouncements and guidelines should be clearly made known to all directors as well as to stockholders and other stakeholders.			
Recommendation 2.1			
1. Directors act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company.	**Compliant**	The Board of Directors is responsible for the overall performance of the Bank. it collegially directs and oversee the affairs of the Bank, while delivering the associated interests in investors and others stakeholders. • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B). • Certification of Directors Attendance for the year 2017 (Annex C).	
Recommendation 2.2			
1. Board oversees the development, review and approval of the company's business objectives and strategy.	**Compliant**	The Board oversees the development, review and approval of the Bank's business objectives and strategy and monitors its implementation during monthly board meetings. • Certification of Directors Attendance for the year 2017 (Annex C). • Manual on Corporate Governance (www.citystatesavings.com).	

2. Board oversees and monitors the implementation of the company's business objectives and strategy.	**Compliant**	• SEC Information Statement-Preliminary 2017	
Supplement to Recommendation 2.2			
1. Board has a clearly defined and updated vision, mission and core values.	**Compliant**	CSBI Website (www.citystatesavings.com) The Mission and Vision are reviewed on an annual basis.	
2. Board has a strategy execution process that facilitates effective management performance and is attuned to the company's business environment, and culture.	**Compliant**	Monthly board meetings discuss the monthly performance, details of business plan results vs. targets, issues and problems encountered and relevant matters affecting results and performance and if there are changes in the strategy to be implemented. • Manual on Corporate Governance as amended April 2017. • Articles of Incorporation and By-Laws	
Recommendation 2.3			
1. Board is headed by a competent and qualified Chairperson.	**Compliant**	• Background Information on the Chairman of the Board of Directors,2017 SEC Form 20-IS • The Chairman of the Board, Duties and Responsibilities is included in the Manual on Corporate Governance as amended April 2017 • Annual Report for the year 2017 (SEC 17-A)	
Recommendation 2.4			

1. Board ensures and adopts an effective succession planning program for directors, key officers and management.	**Compliant**	• Manual on Corporate Governance (www.citystatesavings.com). • Articles of Incorporation and By-Laws • CSBI Succession Planning Program	
2. Board adopts a policy on the retirement for directors and key officers.	**Non-Compliant**		The existing retirement plan only covers employees and key officers of the Bank.
Recommendation 2.5			
1. Board aligns the remuneration of key officers and board members with long-term interests of the company.	**Compliant**	• Annual Report for the year 2017 (SEC 17-A) • Manual on Corporate Governance • Information Statement (Preliminary and Definitive)	
2. Board adopts a policy specifying the relationship between remuneration and performance.	**Compliant**		
3. Directors do not participate in discussions or deliberations involving his/her own remuneration.	**Compliant**		
Optional: Recommendation 2.5			
1. Board approves the remuneration of senior executives.			
2. Company has measurable standards to align the performance-based remuneration of the executive directors and senior executives with long-term interest, such as claw back provision and deferred bonuses.			
Recommendation 2.6			
1. Board has a formal and transparent board nomination and election policy.	**Compliant**	The Bank's Nomination and election policy and process and its implementation , including the criteria	

2. Board nomination and election policy is disclosed in the company's Manual on Corporate Governance.	**Compliant**	used in selecting ne directors, how the shortlisted candidates and how it encourages nominations from shareholders, including minority shareholders, are provided under the • Manual on Corporate Governance as amended April 2017. • Information Statement (Preliminary and Definitive) • Amended By-Laws • Minutes of the Annual Stockholder's Meeting (Annex D)	
3. Board nomination and election policy includes how the company accepted nominations from minority shareholders.	**Compliant**		
4. Board nomination and election policy includes how the board shortlists candidates.	**Compliant**		
5. Board nomination and election policy includes an assessment of the effectiveness of the Board's processes in the nomination, election or replacement of a director.	**Compliant**		
6. Board has a process for identifying the quality of directors that is aligned with the strategic direction of the company.	**Compliant**		
Optional: Recommendation to 2.6			
1. Company uses professional search firms or other external sources of candidates (such as director databases set up by director or shareholder bodies) when searching for candidates to the board of directors.			
Recommendation 2.7			

1. Board has overall responsibility in ensuring that there is a group-wide policy and system governing related party transactions (RPTs) and other unusual or infrequently occurring transactions.	**Compliant**	RPT Policy provides for the responsibilities at different levels of the organization, from the Board, the Governance Committee and the Management, as to the requirement to review and approve material and unusual RPTs and it encompasses all entities within the group, taking into account the size, structure, risk profile and complexity of the operations. • Manual on Corporate Governance • Board Approved Related Party Transactions Charter and Policy and guidelines (Annex E)	
2. RPT policy includes appropriate review and approval of material RPTs, which guarantee fairness and transparency of the transactions.	**Compliant**		
3. RPT policy encompasses all entities within the group, taking into account their size, structure, risk profile and complexity of operations.	**Compliant**		
Supplement to Recommendations 2.7			
1. Board clearly defines the threshold for disclosure and approval of RPTs and categorizes such transactions according to those that are considered *de minimis* or transactions that need not be reported or announced, those that need to be disclosed, and those that need prior shareholder approval. The aggregate amount of RPTs within any twelve (12) month period should be considered for purposes of applying the thresholds for disclosure and approval.	**Compliant**	The Materiality threshold of the Bank for Related Party Transactions are enumerated under Board Approved Related Party Transactions Charter and Policy and Guidelines (Annex E)	

2. Board establishes a voting system whereby a majority of non-related party shareholders approve specific types of related party transactions during shareholders' meetings.	**Compliant**	Minutes of the Annual Stockholder's Meeting (Annex D)	.
Recommendation 2.8			
1. Board is primarily responsible for approving the selection of Management led by the Chief Executive Officer (CEO) and the heads of the other control functions (Chief Risk Officer, Chief Compliance Officer and Chief Audit Executive).	**Compliant**	• Manual on Corporate Governance. • Information Statement (Preliminary and Definitive) • Amended By-Laws • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
2. Board is primarily responsible for assessing the performance of Management led by the Chief Executive Officer (CEO) and the heads of the other control functions (Chief Risk Officer, Chief Compliance Officer and Chief Audit Executive).	**Compliant**	• Amended By-Laws • Manual on Corporate Governance. • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
Recommendation 2.9			
1. Board establishes an effective performance management framework that ensures that Management's performance is at par with the standards set by the Board and Senior Management.	**Compliant**	• Manual on Corporate Governance.	
2. Board establishes an effective performance management framework that ensures that personnel's performance is at par with the standards set by the Board and Senior Management.	**Compliant**	Yearly Performance Appraisal Report (PAR), (Annex F)	
Recommendation 2.10			

1. Board oversees that an appropriate internal control system is in place.	**Compliant**	• Manual on Corporate Governance. • Conflict of Interest Policy (www.citystatesavings.com)	
2. The internal control system includes a mechanism for monitoring and managing potential conflict of interest of the Management, members and shareholders.	**Compliant**		
3. Board approves the Internal Audit Charter.	**Compliant**	• Please see Manual on Corporate Governance • Audit Committee Charter (Annex G)	
Recommendation 2.11			
1. Board oversees that the company has in place a sound enterprise risk management (ERM) framework to effectively identify, monitor, assess and manage key business risks.	**Compliant**	• Please see Manual on Corporate Governance • Annual Report for the year 2017 (SEC 17-A) • CSBI Website (www.citystatesavings.com) • Risk Management Manual (Annex H)	
2. The risk management framework guides the board in identifying units/business lines and enterprise-level risk exposures, as well as the effectiveness of risk management strategies.	**Compliant**		
Recommendation 2.12			

1. Board has a Board Charter that formalizes and clearly states its roles, responsibilities and accountabilities in carrying out its fiduciary role.	**Compliant**	• Please see Manual on Corporate Governance • Amended By-Laws • CSBI Website (www.citystatesavings.com)	
2. Board Charter serves as a guide to the directors in the performance of their functions.	**Compliant**		
3. Board Charter is publicly available and posted on the company's website.	**Compliant**		
Additional Recommendation to Principle 2			
1. Board has a clear insider trading policy.	**Compliant**	• Please refer to CSBI Website (www.citystatesavings.com) Insider Trading Policy	
Optional: Principle 2			
1. Company has a policy on granting loans to directors, either forbidding the practice or ensuring that the transaction is conducted at arm's length basis and at market rates.			
2. Company discloses the types of decision requiring board of directors' approval.			
Principle 3: Board committees should be set up to the extent possible to support the effective performance of the Board's functions, particularly with respect to audit, risk management, related party transactions, and other key corporate governance concerns, such as nomination and remuneration. The composition, functions and responsibilities of all committees established should be contained in a publicly available Committee Charter.			
Recommendation 3.1			

1. Board establishes board committees that focus on specific board functions to aid in the optimal performance of its roles and responsibilities.	**Compliant**	• Please see Manual on Corporate Governance • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
Recommendation 3.2			
1. Board establishes an Audit Committee to enhance its oversight capability over the company's financial reporting, internal control system, internal and external audit processes, and compliance with applicable laws and regulations.	**Compliant**	• Article VI of Amended By-Laws • Audit Committee Charter (Annex G)	
2. Audit Committee is composed of at least three appropriately qualified non-executive directors, the majority of whom, including the Chairman is independent.	**Compliant**	• Audit Committee Charter (Annex G)	
3. All the members of the committee have relevant background, knowledge, skills, and/or experience in the areas of accounting, auditing and finance.	**Compliant**	• Audit Committee Charter (Annex G) • Please see Manual on Corporate Governance All members of the Audit Committee possess all the relevant background, knowledge, skills and experience in the areas of accounting, auditing and finance.	
4. The Chairman of the Audit Committee is not the Chairman of the Board or of any other committee.	**Compliant**	• Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B). The Bank's Audit Committee Chairman is not the chairman of the Board or any of other committee.	
Supplement to Recommendation 3.2			

1. Audit Committee approves all non-audit services conducted by the external auditor.	**Compliant**	• Audit Committee Charter (Annex G) The Audit Committee approves all non-audit services conducted by the external auditors.	
2. Audit Committee conducts regular meetings and dialogues with the external audit team without anyone from management present.	**Compliant**	• Audit Committee Charter (Annex G)	
Optional: Recommendation 3.2			
1. Audit Committee meet at least four times during the year.			
2. Audit Committee approves the appointment and removal of the internal auditor.			
Recommendation 3.3			
1. Board establishes a Corporate Governance Committee tasked to assist the Board in the performance of its corporate governance responsibilities, including the functions that were formerly assigned to a Nomination and Remuneration Committee.	**Compliant**	• Please see Manual on Corporate Governance • Corporate Governance Committee Charter (Annex I)	
2. Corporate Governance Committee is composed of at least three members, all of whom should be independent directors.	**Non-Compliant**		The Bank is guided by BSP Circular No. 749 series of 2012 which provides that the Corporate Governance Committee shall be composed of at least 3 members of the Board, two of whom shall be independent directors including the chairperson.

3. Chairman of the Corporate Governance Committee is an independent director.	**Compliant**	• Corporate Governance Committee Charter (Annex I) • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
Optional: Recommendation 3.3.			
1. Corporate Governance Committee meet at least twice during the year.			
Recommendation 3.4			
1. Board establishes a separate Board Risk Oversight Committee (BROC) that should be responsible for the oversight of a company's Enterprise Risk Management system to ensure its functionality and effectiveness.	**Compliant**	• Please see Manual on Corporate Governance • Risk Oversight Committee Charter (Annex J) • Please refer to CSBI Website (www.citystatesavings.com) •	
2. BROC is composed of at least three members, the majority of whom should be independent directors, including the Chairman.	**Non-Compliant**		The Bank is guided by BSP Circular No. 749 series of 2012 which provides that the Risk Oversight Committee shall be composed of at least 3 members of the board and at least one independent directors, and a chairperson who is a non-executive member.
3. The Chairman of the BROC is not the Chairman of the Board or of any other committee.	**Compliant**	• Please refer to CSBI Website (www.citystatesavings.com) • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
4. At least one member of the BROC has relevant thorough knowledge and experience on risk and risk management.	**Compliant**	• Risk Oversight Committee Charter (Annex J)	
Recommendation 3.5			

1. Board establishes a Related Party Transactions (RPT) Committee, which is tasked with reviewing all material related party transactions of the company.	**Compliant**	• Related Party Committee Charter • Please refer to CSBI Website (www.citystatesavings.com) • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
2. RPT Committee is composed of at least three non-executive directors, two of whom should be independent, including the Chairman.	**Compliant**	• Related Party Committee Charter	
Recommendation 3.6			
1. All established committees have a Committee Charter stating in plain terms their respective purposes, memberships, structures, operations, reporting process, resources and other relevant information.	**Compliant**	• Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
2. Committee Charters provide standards for evaluating the performance of the Committees.	**Compliant**		
3. Committee Charters were fully disclosed on the company's website.	**Compliant**	• Please refer to CSBI Website (www.citystatesavings.com)	
Principle 4: To show full commitment to the company, the directors should devote the time and attention necessary to properly and effectively perform their duties and responsibilities, including sufficient time to be familiar with the corporation's business.			
Recommendation 4.1			
1. The Directors attend and actively participate in all meetings of the Board, Committees and shareholders in person or through tele-/videoconferencing conducted in accordance with the rules and regulations of the Commission.	**Compliant**	• Amended By-Laws • Certification of Directors Attendance for the year 2017 (Annex C).	

2. The directors review meeting materials for all Board and Committee meetings.	**Compliant**	• Amended By-Laws	
3. The directors ask the necessary questions or seek clarifications and explanations during the Board and Committee meetings.	**Compliant**	The directors review meeting materials and seek clarification and explanations during the Board and Committee meetings.	
Recommendation 4.2			
1. Non-executive directors concurrently serve in a maximum of five publicly-listed companies to ensure that they have sufficient time to fully prepare for minutes, challenge Management's proposals/views, and oversee the long-term strategy of the company.	**Compliant**	• Information Statement (Preliminary and Definitive) • Annual Report for the year 2017 (SEC 17-A)	
Recommendation 4.3			
1. The directors notify the company's board before accepting a directorship in another company.	**Compliant**	The Corporate Secretary confirms that directors advice the Office of the Corporate Secretary before accepting any directorships /chairmanships in other companies. Updated bio-data of newly-elected and re-elected directors, are submitted by the directors to the Compliance Department, and forwarded annually to the BSP for confirmation if necessary.	
Optional: Principle 4			
1. Company does not have any executive directors who serve in more than two boards of listed companies outside of the group.			

2. Company schedules board of directors' meetings before the start of the financial year. 3.			
4. Board of directors meet at least six times during the year.			
5. Company requires as minimum quorum of at least 2/3 for board decisions.			
Principle 5: The board should endeavor to exercise an objective and independent judgment on all corporate affairs			
Recommendation 5.1			
1. The Board has at least 3 independent directors or such number as to constitute one-third of the board, whichever is higher.	**Compliant**	• Amended By-Laws • Information Statement (Preliminary and Definitive) • Disclosure on the result of the Annual Stockholder's Meeting, May 30, 2017 (Annex B).	
Recommendation 5.2			
1. The independent directors possess all the qualifications and none of the disqualifications to hold the positions.	**Compliant**	• Please see Manual on Corporate Governance • Amended By-Laws	
Supplement to Recommendation 5.2			
1. Company has no shareholder agreements, by-laws provisions, or other arrangements that constrain the directors' ability to vote independently.	**Compliant**	• Please see Manual on Corporate Governance • Information Statement (Preliminary and Definitive)	
Recommendation 5.3			
1. The independent directors serve for a cumulative term of nine years (reckoned from 2012).	**Compliant**	• Please see Manual on Corporate Governance • Information Statement (Preliminary and Definitive)	

2. The company bars an independent director from serving in such capacity after the term limit of nine years.	**Compliant**	Currently, the Bank has no Independent Directors retained beyond the term limit of nine years, as reckoned from 2012. The Bank has a policy on the term limits of Independent Directors which includes such a provision. • Please see Manual on Corporate Governance • Information Statement (Preliminary and Definitive)	
3. In the instance that the company retains an independent director in the same capacity after nine years, the board provides meritorious justification and seeks shareholders' approval during the annual shareholders' meeting.	**Compliant**	• Please see Manual on Corporate Governance We have no independent directors serving beyond the nine year maximum term.	
Recommendation 5.4			
1. The positions of Chairman of the Board and Chief Executive Officer are held by separate individuals.	**Compliant**	D. Alfred A. Cabangon is Chairman of the Board. Currently the Bank has no CEO. Mr. Benjamin V. Ramos is the President.	
2. The Chairman of the Board and Chief Executive Officer have clearly defined responsibilities.	**Compliant**	• Please see Manual on Corporate Governance • Amended By-Laws	
Recommendation 5.5			
1. If the Chairman of the Board is not an independent director, the board designates a lead director among the independent directors.	**Non-Compliant**		For Banks supervised by the Bangko Sentral ng Pilipinas, the appointment of a Lead Independent Director is not mandatory , and is only required where the positions of Chairman and CEO are held by one person (BSP Circular No. 969 series of 2017).
Recommendation 5.6			

1. Directors with material interest in a transaction affecting the corporation abstain from taking part in the deliberations on the transaction.	**Compliant**	• Please see Manual on Corporate Governance • CSBI website (www.citystatesavings.com) Conflict of Interest Policy and Related Party Transactions Policy	
Recommendation 5.7			
1. The non-executive directors (NEDs) have separate periodic meetings with the external auditor and heads of the internal audit, compliance and risk functions, without any executive present.	**Compliant**	The Board or respective Board Committee freely requests to have an executive session if there is a need to hold. The same was presided by its respective chairman.	
2. The meetings are chaired by the lead independent director.	**Compliant**	Audit Committee, Corporate Governance Committee, Risk Oversight Committee and Related Party Transactions Committee are chaired by the lead independent director (Manual on Corporate Governance as amended April 2017)	
Optional: Principle 5			
1. None of the directors is a former CEO of the company in the past 2 years.			
Principle 6: The best measure of the Board's effectiveness is through an assessment process. The Board should regularly carry out evaluations to appraise its performance as a body, and assess whether it possesses the right mix of backgrounds and competencies.			
Recommendation 6.1			
1. Board conducts an annual self-assessment of its performance as a whole.	**Non-Compliant**		For the year 2017, the Annual self-assessment for the board is being revised. The basis of board's performance was based on their attendance. (Certificate of Attendance for the year 2017 – Annex C)

2. The Chairman conducts a self-assessment of his performance.	**Non-Compliant**		For the year 2017, the Annual self-assessment for the board is being revised. The basis of board's performance was based on his attendance. (Certificate of Attendance for the year 2017 – Annex C)
3. The individual members conduct a self-assessment of their performance.	**Non-Compliant**		For the year 2017, the Annual self-assessment for the board is being revised. The members of the Board of Directors assessed and evaluate individually as a director, and collectively as a board based on their attendance in their committee meeting.
4. Each committee conducts a self-assessment of its performance.	**Non-Compliant**		For the year 2017, the Annual self-assessment for the board is being revised. Based on the assessment of the individual members conduct a self-assessment of their performance, full compliance with this is taking into account the size, structure, risk profile and complexity of operations of the Bank.
5. Every three years, the assessments are supported by an external facilitator.	**Non-Compliant**		For the year 2017, the Annual self-assessment for the board is being revised. With 2017 as reckoning year, our Company intends to comply and engage an external facilitator in the future.
Recommendation 6.2			
1. Board has in place a system that provides, at the minimum, criteria and process to determine the performance of the Board, individual directors and committees.	**Non-Compliant**	Provide information or link/reference to a document containing information on the system of the company to evaluate the performance of the board, individual directors and committees, including a feedback	With 2017 as reckoning year, our Company intends to in place a system that provides, at the minimum, criteria and process to determine the performance of the Board, individual directors and committees.

2. The system allows for a feedback mechanism from the shareholders.	**Compliant**	mechanism from shareholders	Our Investor Relation Unit allows for a feedback mechanism of shareholders and stakeholders to communicate or raise governance issues.
Principle 7: Members of the Board are duty-bound to apply high ethical standards, taking into account the interests of all stakeholders.			
Recommendation 7.1			
1. Board adopts a Code of Business Conduct and Ethics, which provide standards for professional and ethical behavior, as well as articulate acceptable and unacceptable conduct and practices in internal and external dealings of the company.	**Compliant**	Provide information on or link/reference to the company's Code of Business Conduct and Ethics.	
2. The Code is properly disseminated to the Board, senior management and employees.	**Compliant**	Code of Business Conduct and Ethics (www.citystatesavings.com/corporate-governance/code-of-business-conduct-and-ethics) Codes are properly disseminated to the Board, Senior Management and employees.	
3. The Code is disclosed and made available to the public through the company website.	**Compliant**	CSBI Website (www.citystatesavings.com) Code of Business Conduct and Ethics	
Supplement to Recommendation 7.1			
1. Company has clear and stringent policies and procedures on curbing and penalizing company involvement in offering, paying and receiving bribes.	**Compliant**	CSBI Website (www.citystatesavings.com) Code of Business Conduct and Ethics	
Recommendation 7.2			

1. Board ensures the proper and efficient implementation and monitoring of compliance with the Code of Business Conduct and Ethics.	**Compliant**	Directors, Officers and Employees are required to certify their compliance with the code. The Bank's Human Resources Department has the primary responsibility to implement and administer the Code of Business Conduct and Ethics to all Employees through on boarding and refresher orientation. Ethics is embedded in the job descriptions and performance evaluation process. The Code of Business Conduct and Ethics is communicated with all departments in all levels across the company. Alleged breach of conduct is investigated and due process is observed. Code violations are taken seriously and may result to disciplinary action, up to and including termination of employment and possible legal action.	
2. Board ensures the proper and efficient implementation and monitoring of compliance with company internal policies.	**Compliant**		
Disclosure and Transparency			
Principle 8: The company should establish corporate disclosure policies and procedures that are practical and in accordance with best practices and regulatory expectations.			
Recommendation 8.1			

1. Board establishes corporate disclosure policies and procedures to ensure a comprehensive, accurate, reliable and timely report to shareholders and other stakeholders that gives a fair and complete picture of a company's financial condition, results and business operations.	**Compliant**	• Please see Manual on Corporate Governance as amended April 2017 • CSBI website (www.citystatesavings.com) This webpage includes disclosures for stockholders and other stakeholders that give fair and complete picture of a Company's financial condition, results and business operations. The Company is fully compliant with mandatory disclosure requirements of the regulators.	
Supplement to Recommendations 8.1			

1. Company distributes or makes available annual and quarterly consolidated reports, cash flow statements, and special audit revisions. Consolidated financial statements are published within ninety (90) days from the end of the fiscal year, while interim reports are published within forty-five (45) days from the end of the reporting period.	**Compliant**	CSB practices regular disclosure of financial results. Annual report are presented to the Board of director before disclosure and immediately disclosed to the SEC and PSE. Quarterly and Annual Reports and detailed management's discussion and analysis are filed within the mandated 45 and 105 calendar days respectively at the end of fiscal period, if not earlier. The company's financial reporting disclosure are in compliance with BSP, PSE and SEC. These reports are made available to investors are posted as well on the PSE EDGE and on the Company's website. Citystate Savings Bank, Inc. website (wwww.citystatesavings.com)	
2. Company discloses in its annual report the principal risks associated with the identity of the company's controlling shareholders; the degree of ownership concentration; cross-holdings among company affiliates; and any imbalances between the controlling shareholders' voting power and overall equity position in the company.	**Compliant**	Annual Report for the year 2017 (SEC 17-A) The company's Annual Report contains a discussion on the security ownership of certain record and beneficial owners and a management, the indirect shareholdings of the directors, officers and principal shareholdings, voting trust of shareholders and changes in control.	
Recommendation 8.2			

1. Company has a policy requiring all directors to disclose/report to the company any dealings in the company's shares within three business days.	**Compliant**	• Please see Manual on Corporate Governance as amended April 2017 • CSBI website (www.citystatesavings.com) Insiders Trading Policy requires all directors and key officers to disclose transactions with company shares within two (2) business days from transaction date.	
2. Company has a policy requiring all officers to disclose/report to the company any dealings in the company's shares within three business days.	**Compliant**		
Supplement to Recommendation 8.2			
1. Company discloses the trading of the corporation's shares by directors, officers (or persons performing similar functions) and controlling shareholders. This includes the disclosure of the company's purchase of its shares from the market (e.g. share buy-back program).	**Compliant**	These reports are made available to investors are posted as well on the PSE EDGE and on the Company's website. Citystate Savings Bank, Inc. website (wwww.citystatesavings.com) SEC 20 IS, shareholdings of Directors, management	
Recommendation 8.3			
1. Board fully discloses all relevant and material information on individual board members to evaluate their experience and qualifications, and assess any potential conflicts of interest that might affect their judgment.	**Compliant**	Annual Report for the year 2017 (SEC 17-A) Background information on Directors and Officers, 2017 SEC Form 20-IS	
2. Board fully discloses all relevant and material information on key executives to evaluate their experience and qualifications, and assess any potential conflicts of interest that might affect their judgment.	**Compliant**	Annual Report for the year 2017 (SEC 17-A) Background information on Directors and Officers, 2017 SEC Form 20-IS	

Recommendation 8.4			
1. Company provides a clear disclosure of its policies and procedure for setting Board remuneration, including the level and mix of the same.	**Compliant**	Please see Manual on Corporate Governance SEC 20-Information Statement (Preliminary and Definitive)	
2. Company provides a clear disclosure of its policies and procedure for setting executive remuneration, including the level and mix of the same.	**Compliant**	Please see Manual on Corporate Governance SEC 20-Information Statement (Preliminary and Definitive)	
3. Company discloses the remuneration on an individual basis, including termination and retirement provisions.	**Compliant**	Please see Manual on Corporate Governance SEC 20-Information Statement (Preliminary and Definitive)	
Recommendation 8.5			
1. Company discloses its policies governing Related Party Transactions (RPTs) and other unusual or infrequently occurring transactions in their Manual on Corporate Governance.	**Compliant**	Please see Manual on Corporate Governance Board Approved Related Party Transactions Charter and Policy and guidelines (Annex E)	
2. Company discloses material or significant RPTs reviewed and approved during the year.	**Compliant**	Annual Report for the year 2017 (SEC 17-A)	
Supplement to Recommendation 8.5			

1. Company requires directors to disclose their interests in transactions or any other conflict of interests.	**Compliant**	Board Approved Related Party Transactions Charter and Policy and guidelines (Annex E) All directors, officers and employees are expected to promote the Company's interest. They shall not compete with the Company, nor shall they allow business dealing on behalf of the Company to be influenced, and or appear to be influenced by their own personal or family interests.	
Optional : Recommendation 8.5			
1. Company discloses that RPTs are conducted in such a way to ensure that they are fair and at arms' length.			
Recommendation 8.6			
1. Company makes a full, fair, accurate and timely disclosure to the public of every material fact or event that occur, particularly on the acquisition or disposal of significant assets, which could adversely affect the viability or the interest of its shareholders and other stakeholders.	**Compliant**	The Company complies with the disclosure requirements of the SEC and PSE. • CSBI website (www.citystatesavings.com)	
2. Board appoints an independent party to evaluate the fairness of the transaction price on the acquisition or disposal of assets.	**Non-Compliant**		For 2017, no independent party was appointed. However, the transactions were fair and reasonable under the circumstances as approved by the Board of Directors.
Supplement to Recommendation 8.6			

1. Company discloses the existence, justification and details on shareholder agreements, voting trust agreements, confidentiality agreements, and such other agreements that may impact on the control, ownership, and strategic direction of the company.	**Compliant**	SEC 20-Information Statement (Preliminary and Definitive)	
Recommendation 8.7			
1. Company's corporate governance policies, programs and procedures are contained in its Manual on Corporate Governance (MCG).	**Compliant**	The Company complies with the disclosure requirements of the SEC and PSE. • CSBI website (www.citystatesavings.com)	
2. Company's MCG is submitted to the SEC and PSE.	**Compliant**		
3. Company's MCG is posted on its company website.	**Compliant**		
Supplement to Recommendation 8.7			
1. Company submits to the SEC and PSE an updated MCG to disclose any changes in its corporate governance practices.	**Compliant**	Please see Manual on Corporate Governance, posted at www.citystatesavings.com	
Optional: Principle 8			
1. Does the company's Annual Report disclose the following information:	**Compliant**	Annual Report for the year 2017 (SEC 17-A)	
a. Corporate Objectives	**Compliant**		
b. Financial performance indicators	**Compliant**		
c. Non-financial performance indicators	**Compliant**		

d. Dividend Policy	**Compliant**		
e. Biographical details (at least age, academic qualifications, date of first appointment, relevant experience, and other directorships in listed companies) of all directors	**Compliant**		
f. Attendance details of each director in all directors meetings held during the year	**Non-Compliant**		The Company does not state the directors' attendance in the Annual Report. Should it be required, the Company will comply.
g. Total remuneration of each member of the board of directors	**Compliant**		
2. The Annual Report contains a statement confirming the company's full compliance with the Code of Corporate Governance and where there is non-compliance, identifies and explains reason for each such issue.	**Compliant**	Part IV of Annual Report for the year 2017 (SEC 17-A)	
3. The Annual Report/Annual CG Report discloses that the board of directors conducted a review of the company's material controls (including operational, financial and compliance controls) and risk management systems.	**Compliant**	The Audit Committee assists the Board of Directors in carrying out its responsibilities as they relate to its oversight of the Company's internal control, internal audit function, legal and regulatory requirements and corporate governance. Annual Report for the year 2017 (SEC 17-A)	

4. The Annual Report/Annual CG Report contains a statement from the board of directors or Audit Committee commenting on the adequacy of the company's internal controls/risk management systems.	**Compliant**	Annual Report for the year 2017 (SEC 17-A)	
5. The company discloses in the Annual Report the key risks to which the company is materially exposed to (i.e. financial, operational including IT, environmental, social, economic).	**Compliant**	Annual Report for the year 2017 (SEC 17-A) – Part 1	
Principle 9: The company should establish standards for the appropriate selection of an external auditor, and exercise effective oversight of the same to strengthen the external auditor's independence and enhance audit quality.			
Recommendation 9.1			
1. Audit Committee has a robust process for approving and recommending the appointment, reappointment, removal, and fees of the external auditors.	**Compliant**	The Audit Committee has the authority to recommend the appointment and compensation of the independent external auditor and oversee their work performance. Annual Report for the year 2017 (SEC 17-A) SEC 20-Information Statement (Preliminary and Definitive)	
2. The appointment, reappointment, removal, and fees of the external auditor is recommended by the Audit Committee, approved by the Board and ratified by the shareholders.	**Compliant**	Annual Report for the year 2017 (SEC 17-A) SEC 20-Information Statement (Preliminary and Definitive) Minutes of the Annual Stockholders' Meeting	

3. For removal of the external auditor, the reasons for removal or change are disclosed to the regulators and the public through the company website and required disclosures.	**Compliant**	The company engaged the same external auditor. Annual Report for the year 2017 (SEC 17-A) SEC 20-Information Statement (Preliminary and Definitive)	
Supplement to Recommendation 9.1			
1. Company has a policy of rotating the lead audit partner every five years.	**Compliant**	Annual Report for the year 2017 (SEC 17-A) SEC 20-Information Statement (Preliminary and Definitive)	
Recommendation 9.2			
1. Audit Committee Charter includes the Audit Committee's responsibility on: i. assessing the integrity and independence of external auditors; ii. exercising effective oversight to review and monitor the external auditor's independence and objectivity; and iii. exercising effective oversight to review and monitor the effectiveness of the audit process, taking into consideration relevant Philippine professional and regulatory requirements.	**Compliant**	Please see Manual on Corporate Governance as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	
2. Audit Committee Charter contains the Committee's responsibility on reviewing and monitoring the external auditor's suitability and effectiveness on an annual basis.	**Compliant**	Please see Manual on Corporate Governance as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	

Supplement to Recommendations 9.2			
1. Audit Committee ensures that the external auditor is credible, competent and has the ability to understand complex related party transactions, its counterparties, and valuations of such transactions.	**Compliant**	Please see Manual on Corporate Governance as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	
2. Audit Committee ensures that the external auditor has adequate quality control procedures.	**Compliant**	Please see Manual on Corporate Governance as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	
Recommendation 9.3			
1. Company discloses the nature of non-audit services performed by its external auditor in the Annual Report to deal with the potential conflict of interest.	**Compliant**	This is included in the Duties and Responsibilities of the Audit Committee, stated in the Committee Charter. Please see Manual on Corporate Gove as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	

2. Audit Committee stays alert for any potential conflict of interest situations, given the guidelines or policies on non-audit services, which could be viewed as impairing the external auditor's objectivity.	**Compliant**	This is included in the Duties and Responsibilities of the Audit Committee, as stated in the Committee Charter. Please see Manual on Corporate Governance as amended April 2017, posted at www.citystatesavings.com Audit Committee Charter	
Supplement to Recommendation 9.3			
1. Fees paid for non-audit services do not outweigh the fees paid for audit services.	**Compliant**	Annual Report for the year 2017 (SEC 17-A)	
Additional Recommendation to Principle 9			
1. Company's external auditor is duly accredited by the SEC under Group A category.	**Compliant**	Punongbayan & Araulo SEC Group A 0002-FR-5 January 03,2018 March 26, 2021 20th Floor, Tower 1 The Enterprises Center 6766 Ayala Avenue 1200 Makati City, Philippines 632 988 2288	
2. Company's external auditor agreed to be subjected to the SEC Oversight Assurance Review (SOAR) Inspection Program conducted by the SEC's Office of the General Accountant (OGA).	**Compliant**	Romualdo V. Murcia III November 29, 2019 Punongbayan & Araulo 20th Floor, Tower 1 The Enterprises Center 6766 Ayala Avenue 1200 Makati City, Philippines 632 988 2288	
Principle 10: The company should ensure that the material and reportable non-financial and sustainability issues are disclosed.			
Recommendation 10.1			

1. Board has a clear and focused policy on the disclosure of non-financial information, with emphasis on the management of economic, environmental, social and governance (EESG) issues of its business, which underpin sustainability.	**Compliant**	We provide in our website disclosures on non-financial information such as our advocacies and the different programs and initiatives we undertake that highlights our corporate social responsibility. The management give emphasis on economic, environmental and governance issues of its business by posting in its website. www.citystatesavings.com	
2. Company adopts a globally recognized standard/framework in reporting sustainability and non-financial issues.	**Compliant**	We provide in our website disclosures on non-financial information such as our advocacies and the different programs and initiatives we undertake that highlights our corporate social responsibility. The management give emphasis on economic, environmental and governance issues of its business by posting in its website. www.citystatesavings.com	
Principle 11: The company should maintain a comprehensive and cost-efficient communication channel for disseminating relevant information. This channel is crucial for informed decision-making by investors, stakeholders and other interested users.			
Recommendation 11.1			
1. Company has media and analysts' briefings as channels of communication to ensure the timely and accurate dissemination of public, material and relevant information to its shareholders and other investors.	**Compliant**	The Company disseminates and discloses material and relevant information through its website, press releases and disclosures to PSE and SEC. www.citystatesavings.com PSE-EDGE Disclosure SEC Disclosure	

Supplemental to Principle 11			
1. Company has a website disclosing up-to-date information on the following:	**Compliant**	Citystate Savings Bank, Inc. Website: www.citystatesavings.com	
a. Financial statements/reports (latest quarterly)	**Compliant**		
b. Materials provided in briefings to analysts and media	**Compliant**		
c. Downloadable annual report	**Compliant**		
d. Notice of ASM and/or SSM	**Compliant**		
e. Minutes of ASM and/or SSM	**Compliant**		
f. Company's Articles of Incorporation and By-Laws	**Compliant**		
Additional Recommendation to Principle 11			
1. Company complies with SEC-prescribed website template.	**Compliant**	Website: www.citystatesavings.com	
Internal Control System and Risk Management Framework			
Principle 12: To ensure the integrity, transparency and proper governance in the conduct of its affairs, the company should have a strong and effective internal control system and enterprise risk management framework.			
Recommendation 12.1			

1. Company has an adequate and effective internal control system in the conduct of its business.	**Compliant**	The Audit and Risk Oversight Committee of the Company is responsible for overseeing senior management in establishing and maintaining an adequate, effective and efficient internal control network. It ensures that systems and processes are designed to provide assurance in areas including reporting, monitoring, compliance with laws, regulations and internal policies, efficiency and effectiveness of operations, and safeguarding of assets. Through the Internal Auditor, the Corporation monitors and evaluates the adequacy and effectiveness of the Corporation's internal control system, integrity of financial reporting, and security of physical and information assets. Manual on Corporate Governance as amended April 2018 posted in CSB website.	
2. Company has an adequate and effective enterprise risk management framework in the conduct of its business.	**Compliant**	Website: www.citystatesavings.com Enterprise Risk Management Policy Risk Oversight Committee Charter Annual Report for the year 2017 (SEC 17-A)	
Supplement to Recommendations 12.1			

1. Company has a formal comprehensive enterprise-wide compliance program covering compliance with laws and relevant regulations that is annually reviewed. The program includes appropriate training and awareness initiatives to facilitate understanding, acceptance and compliance with the said issuances.	**Compliant**	Review and frequency of the compliance program is based on the risk assessment conducted at the respective business units, and at the minimum, is done annually. Annual Report for the year 2017	
Optional: Recommendation 12.1			
1. Company has a governance process on IT issues including disruption, cyber security, and disaster recovery, to ensure that all key risks are identified, managed and reported to the board.			
Recommendation 12.2			
1. Company has in place an independent internal audit function that provides an independent and objective assurance, and consulting services designed to add value and improve the company's operations.	**Compliant**	Citystate Savings Bank, Inc. has an in-house Internal Audit.	
Recommendation 12.3			
1. Company has a qualified Chief Audit Executive (CAE) appointed by the Board.	**Compliant**	Mr. Emerson G. Igarta is the Bank's head of Internal Audit	

2. CAE oversees and is responsible for the internal audit activity of the organization, including that portion that is outsourced to a third party service provider.	**Compliant**	Audit Committee is responsible for the internal audit activity of the organization, including that portion is outsourced to a third party service provider. CSB Internal Audit has no outsourced activity to a third party provider. Internal audit Manual Amended By-Laws	
3. In case of a fully outsourced internal audit activity, a qualified independent executive or senior management personnel is assigned the responsibility for managing the fully outsourced internal audit activity.	**Compliant**	This is not applicable to CSB which has an in-house Internal Audit Department and does not outsource activity to a third party provider.	
Recommendation 12.4			
1. Company has a separate risk management function to identify, assess and monitor key risk exposures.	**Compliant**	The Risk Oversight Committee has been established by the Board to assist in the development and oversight of the Company's risk management program. www.cityastatesavings.com – Risk oversight Committee	
Supplement to Recommendation 12.4			

1. Company seeks external technical support in risk management when such competence is not available internally.	**Non-Compliant**	Identify source of external technical support, if any.	The Bank currently does not require assistance of external technical support in risk management. Based on the assessment of the Board of Directors, full compliance with this recommendation is not necessary taking into account the size, structure, risk profile and complexity of operations of the Bank. The same will be implemented when the needs of the Company require so.
Recommendation 12.5			
1. In managing the company's Risk Management System, the company has a Chief Risk Officer (CRO), who is the ultimate champion of Enterprise Risk Management (ERM).	**Compliant**	Mr. Michael M. Boado is the Bank's Chief Risk Officer, effective April 2018	
2. CRO has adequate authority, stature, resources and support to fulfill his/her responsibilities.	**Compliant**	CSB Chief Risk Officer is an Assistant Vice President.	
Additional Recommendation to Principle 12			
1. Company's Chief Executive Officer and Chief Audit Executive attest in writing, at least annually, that a sound internal audit, control and compliance system is in place and working effectively.	**Non-Compliant**		The bank has no CEO; and the CAE is currently on medical leave since February 2018.
Cultivating a Synergic Relationship with Shareholders			
Principle 13: The company should treat all shareholders fairly and equitably, and also recognize, protect and facilitate the exercise of their rights.			
Recommendation 13.1			
1. Board ensures that basic shareholder rights are disclosed in the Manual on Corporate Governance.	**Compliant**	www.citystatesavings.com – Manual On Corporate Governance	
2. Board ensures that basic shareholder rights are disclosed on the company's website.	**Compliant**	www.citystatesavings.com – Manual On Corporate Governance	

Supplement to Recommendation 13.1			
1. Company's common share has one vote for one share.	**Compliant**	www.citystatesavings.com – Articles of Incorporation, Amended By-Laws and SEC 20-IS	
2. Board ensures that all shareholders of the same class are treated equally with respect to voting rights, subscription rights and transfer rights.	**Compliant**	The Company has 100,000,000 shares. All shares have the same rights for voting, subscription and transfer.	
3. Board has an effective, secure, and efficient voting system.	**Compliant**	www.citystatesavings.com – Articles of Incorporation, Amended By-Laws, SEC 20-IS and Manual on Corporate Governance	
4. Board has an effective shareholder voting mechanisms such as supermajority or "majority of minority" requirements to protect minority shareholders against actions of controlling shareholders.	**Compliant**	www.citystatesavings.com – Articles of Incorporation, Amended By-Laws, SEC 20-IS and Manual on Corporate Governance	
5. Board allows shareholders to call a special shareholders' meeting and submit a proposal for consideration or agenda item at the AGM or special meeting.	**Compliant**	Manual on Corporate Governance Amended By-Laws – Stockholders Meeting	
6. Board clearly articulates and enforces policies with respect to treatment of minority shareholders.	**Compliant**	The Company promotes a culture of transparency with protection and equal respect of shareholder/investor rights embodied in its Manual on Corporate Governance as amended April 2017.	
7. Company has a transparent and specific dividend policy.	**Compliant**	2017 Annual Report submitted to SEC (SEC Form 17-A), Definitive Information Statement (SEC Form 20-IS)	
Optional: Recommendation 13.1			

1. Company appoints an independent party to count and/or validate the votes at the Annual Shareholders' Meeting.			
Recommendation 13.2			
1. Board encourages active shareholder participation by sending the Notice of Annual and Special Shareholders' Meeting with sufficient and relevant information at least 28 days before the meeting.	**Compliant**	For 2017, the Company sent out Notice of Annual or Special Shareholders' Meeting on March 06, 2018 and posted in CSB website (www.citystatesavings.com) http://edge.pse.com.ph/openDiscViewer.do?edge_no=68db38b85d90e17b43ca035510b6ec2b#sthash.QkOfEFHv.dpbs	
Supplemental to Recommendation 13.2			
1. Company's Notice of Annual Stockholders' Meeting contains the following information:	**Compliant**	Posted in CSB website: www.citystatesavings.com Definitive Information Statement (SEC Form 20-IS) Notice of annual or Special Stockholders' Meeting	
a. The profiles of directors (i.e., age, academic qualifications, date of first appointment, experience, and directorships in other listed companies)	**Compliant**	Posted in CSB website: www.citystatesavings.com Definitive Information Statement (SEC Form 20-IS) Directors' business experience are indicated in this report.	
b. Auditors seeking appointment/re-appointment	**Compliant**	Posted in CSB website: www.citystatesavings.com Definitive Information Statement (SEC Form 20-IS)	

c. Proxy documents	**Compliant**	Posted in CSB website: www.citystatesavings.com Definitive Information Statement (SEC Form 20-IS)	
Optional: Recommendation 13.2			
1. Company provides rationale for the agenda items for the annual stockholders meeting	**Compliant**	Posted in CSB website: www.citystatesavings.com Notice of annual or Special Stockholders' Meeting Explanation of Agenda Items is included in the Notice of Annual Stockholders' meeting.	
Recommendation 13.3			
1. Board encourages active shareholder participation by making the result of the votes taken during the most recent Annual or Special Shareholders' Meeting publicly available the next working day.	**Compliant**	Result of Annual Stockholders Meeting and Organizational meeting was posted to the PSE right after the meeting. Minutes of the Annual Stockholders Meeting posted in the CSB website.	
2. Minutes of the Annual and Special Shareholders' Meetings were available on the company website within five business days from the end of the meeting.	**Compliant**	Minutes of the Annual Stockholders Meeting posted in the CSB website. CSB website: www.citystatesavings.com	
Supplement to Recommendation 13.3			
1. Board ensures the attendance of the external auditor and other relevant individuals to answer shareholders questions during the ASM and SSM.	**Compliant**	Result of Annual Stockholders Meeting and Organizational meeting was posted to the PSE right after the meeting and in CSB website (www.citystatesavings.com)	

Recommendation 13.4			
1. Board makes available, at the option of a shareholder, an alternative dispute mechanism to resolve intra-corporate disputes in an amicable and effective manner.	**Compliant**	The Company has designated an investor relations officer to handle investor and shareholder queries and requests, and his contact information can easily be accessed through the Company's website. Any further issue will be escalated either to the Management or Board of Directors for proper resolution.	
2. The alternative dispute mechanism is included in the company's Manual on Corporate Governance.	**Compliant**	Manual on Corporate Governance as amended April 2017, p. 7-10. Posted in the CSB website (www.citystatesavings.com)	
Recommendation 13.5			
1. Board establishes an Investor Relations Office (IRO) to ensure constant engagement with its shareholders.	**Compliant**	Investor Relations Office (IRO) is disclose in the CSB website (www.citystatesavings.com)	
2. IRO is present at every shareholder's meeting.	**Compliant**	IRO was present last Annual Stockholders' Meeting.	
Supplemental Recommendations to Principle 13			
1. Board avoids anti-takeover measures or similar devices that may entrench ineffective management or the existing controlling shareholder group	**Compliant**	There are no capital structures or arrangements that enable certain shareholders to obtain a degree of control, i.e, shareholders agreement, voting cap, multiple voting rights, pyramid structures or crossholding structures. The voting procedures discussed earlier in the document also support that the Board does not have any anti-takeover measures in place.	

2. Company has at least thirty percent (30%) public float to increase liquidity in the market.	**Non-Compliant**		The proportion of the Corporation's outstanding shares that are considered public float is less than 30% (i.e. only 18.13%). Based on the assessment of the Board of Directors, full compliance with this recommendation is not necessary taking into account the size, structure, risk profile and complexity of operations of the Corporation. Public Ownership Report posted in the CSB website.
Optional: Principle 13			
1. Company has policies and practices to encourage shareholders to engage with the company beyond the Annual Stockholders' Meeting			
2. Company practices secure electronic voting in absentia at the Annual Shareholders' Meeting.			
Duties to Stakeholders			
Principle 14: The rights of stakeholders established by law, by contractual relations and through voluntary commitments must be respected. Where stakeholders' rights and/or interests are at stake, stakeholders should have the opportunity to obtain prompt effective redress for the violation of their rights.			
Recommendation 14.1			
1. Board identifies the company's various stakeholders and promotes cooperation between them and the company in creating wealth, growth and sustainability.	**Compliant**	Refer to Manual on Corporate Governance, Annual Report, Information Statement posted in CSB website (www.citystatesavings.com)	
Recommendation 14.2			

1. Board establishes clear policies and programs to provide a mechanism on the fair treatment and protection of stakeholders.	**Compliant**	Refer to Manual on Corporate Governance, Annual Report, Information Statement posted in CSB website (www.citystatesavings.com)	
Recommendation 14.3			
1. Board adopts a transparent framework and process that allow stakeholders to communicate with the company and to obtain redress for the violation of their rights.	**Compliant**	Whistle Blowing Policy is posted in CSB website (www.citytatesavings.com) and Investor Relation Office.	
Supplement to Recommendation 14.3			
1. Company establishes an alternative dispute resolution system so that conflicts and differences with key stakeholders is settled in a fair and expeditious manner.	**Compliant**	The Company has designated an investor relations officer to handle investor and shareholder queries and requests, and his contact information can easily be accessed through the Company's website. Any further issue will be escalated either to the Management or Board of Directors for proper resolution.	
Additional Recommendations to Principle 14			
1. Company does not seek any exemption from the application of a law, rule or regulation especially when it refers to a corporate governance issue. If an exemption was sought, the company discloses the reason for such action, as well as presents the specific steps being taken to finally comply with the applicable law, rule or regulation.	**Compliant**	No instances in 2017.	

2. Company respects intellectual property rights.	**Compliant**	Policies for the protection of intellectual property rights are found in the Code Discipline HRD Operating Manual database of the Bank for internal use of employees.	
Optional: Principle 14			
1. Company discloses its policies and practices that address customers' welfare			
2. Company discloses its policies and practices that address supplier/contractor selection procedures			
Principle 15: A mechanism for employee participation should be developed to create a symbiotic environment, realize the company's goals and participate in its corporate governance processes.			
Recommendation 15.1			
1. Board establishes policies, programs and procedures that encourage employees to actively participate in the realization of the company's goals and in its governance.	**Compliant**	CSB website (www.citystatesavings.com) – Company's Policy	
Supplement to Recommendation 15.1			
1. Company has a reward/compensation policy that accounts for the performance of the company beyond short-term financial measures.	**Compliant**	The company has its policy on reward / compensation to recognize employees' performance based on Performance Appraisal Report (PAR).	
2. Company has policies and practices on health, safety and welfare of its employees.	**Compliant**	CSB website (www.citystatesavings.com) – Company's Policy (Health Safety and Welfare of Employees)	

3. Company has policies and practices on training and development of its employees.	**Compliant**	New employees are given orientation on the Company's policies and procedures and made to undergo basic insurance and reinsurance training. Depending on their work assignment and employee development plans, employees undergo or are sent to specialized training courses.	
Recommendation 15.2			
1. Board sets the tone and makes a stand against corrupt practices by adopting an anti-corruption policy and program in its Code of Conduct.	**Compliant**	CSB website (www.citystatesavings.com) – Code of Business Conducts and Ethics Policy and Conflict of Interest Policy	
2. Board disseminates the policy and program to employees across the organization through trainings to embed them in the company's culture.	**Compliant**	CSB website (www.citystatesavings.com) – Code of Business Conducts and Ethics Policy and Conflict of Interest Policy	
Supplement to Recommendation 15.2			
1. Company has clear and stringent policies and procedures on curbing and penalizing employee involvement in offering, paying and receiving bribes.	**Compliant**	CSB website (www.citystatesavings.com) – Whistle Blowing Policy	
Recommendation 15.3			
1. Board establishes a suitable framework for whistleblowing that allows employees to freely communicate their concerns about illegal or unethical practices, without fear of retaliation	**Compliant**	CSB website (www.citystatesavings.com) – Code of Business Conducts and Ethics Policy and Whistle Blowing Policy	
2. Board establishes a suitable framework for whistleblowing that allows employees to have direct access to an independent member of the Board or a unit created to handle whistleblowing concerns.	**Compliant**	CSB website (www.citystatesavings.com) – Code of Business Conducts and Ethics Policy and Whistle Blowing Policy	

3. Board supervises and ensures the enforcement of the whistleblowing framework.	**Compliant**	CSB website (www.citystatesavings.com) – Code of Business Conducts and Ethics Policy and Whistle Blowing Policy	
Principle 16: The company should be socially responsible in all its dealings with the communities where it operates. It should ensure that its interactions serve its environment and stakeholders in a positive and progressive manner that is fully supportive of its comprehensive and balanced development.			
Recommendation 16.1			
1. Company recognizes and places importance on the interdependence between business and society, and promotes a mutually beneficial relationship that allows the company to grow its business, while contributing to the advancement of the society where it operates.	**Compliant**	CSB website (www.citystatesavings.com) – Corporate Social Responsibility Our Tagline "WE TAKE CARE OF YOU" is manifested through the banks excellent supervision and sound decision-making, strategic planning with enhanced policies, investments with innovative product lines and services for our customers. These are the hemisphere that the bank evolves; the other half of our dedication is social responsibility through Eco-friendly projects, orphanage visitation and community feeding program, education and relevant development programs, thriftiness awareness and financial literacy. These are the activities attuned with the corporate social responsibility of Citystate Savings Bank. WE TAKE CARE OF YOU, doing the extra mile in providing better lives for Filipinos and the community.	
Optional: Principle 16			

1. Company ensures that its value chain is environmentally friendly or is consistent with promoting sustainable development			
2. Company exerts effort to interact positively with the communities in which it operates			

SIGNATURES

Pursuant to the requirement of the Securities and Exchange Commission, this Integrated Annual Corporate Governance Report is signed on behalf of the registrant by the undersigned, thereunto duly authorized, in the City of Pasig on May 29, 2018.

CITYSTATE SAVINGS BANK, INC.

D. Alfred A. Cabangon
Chairman of the Board

Mr. Benjamin V. Ramos
President

Mr. Lucito L. Sioson
Independent Director

Justice Armando R. Melo
Independent Director

Mr. Wilfredo S. Madarang, Jr.
Independent Director

Atty. Christian M. Chavez
Chief Compliance Officer

Atty. Socrates M. Arevalo
Corporate Secretary

SUBSCRIBE AND SWORN to before me at MAKATI CITY Metro Manila this MAY 3 0 2018; affiant(s) exhibiting to me his Tax Identification Number (TIN) with the following details:

D. ALFRED A. CABANGON	TIN NO. 112-826-100
MR. BENJAMIN V. RAMOS	TIN NO. 116-889-795
MR. LUCITO L. SIOSON	TIN NO. 106-213-585
JUSTICE ARMANDO R. MELO	TIN NO. 118-041-583
MR. WILFREDO S. MADARANG, JR.	TIN NO. 112-071-504
ATTY. SOCRATES M. AREVALO	TIN NO. 123-271-382
ATTY. CHRISTIAN M. CHAVEZ	TIN NO. 251-978-768
Mr. JESUS VICENTE O. GARCIA	TIN NO. 123-093-782

Doc. No. 465;
Page No. 94;
Book No. 7;
Series of 2018.

EDUARDO B. DE JESUS
Notary Public
Docket No. M-134 (2017-2018)
Until December 31, 2018
2232 Don Chino Roces Avenue, Makati City, MM.
IBP Life Member # 010568 (2.3.12)
PTR # 5909049 (Makati City, 1.03.17)
MCLE Compliance # V-0011417 (11.02.2015)
Attorney's Roll No. 35993

ANNEX A

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Dominic Alfred A. Cabangon

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Alfonso G. Siy

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Benjamin V. Ramos
Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Jesus Wilfredo A. Cabagon

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

D. Arnold A. Cabangon

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.,

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Feorelio M. Bote

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Michael F. Rellosa

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Emmanuel R. Sison

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Ramon L. Sin

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Susan M. Belen

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Pedro E. Paraiso

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Wilfredo S. Madarang, Jr.

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Lucito D. Sioson

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Socrates M. Arevalo

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Emerson G. Igarta

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Des Corazon D. Cruz

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Irish Janne B. Escio

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Joseph D. Gonzaga

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Eduardo L. De Jesus

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Martin Jerry E. Machado

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

Institute of Corporate Directors

presents this

Certificate of Attendance

to

Amerjaphil T. Tugade

Citystate Savings Bank

for having attended the Advanced Corporate Governance Training Program held on December 19, 2017 at 20/F Citystate Centre Building, Eternal Plans Inc., Function Room, Citystate Centre Building, Shaw Boulevard, Pasig, 1600 Metro Manila, Philippines.

Given this 19th day of December 2017.

Ricardo Nicanor N. Jacinto
Chief Executive Officer

ANNEX B

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-C

CURRENT REPORT UNDER SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17.2(c) THEREUNDER

1. May 30, 2017
Date of Report (Date of earliest event reported)

2. SEC Identification Number A 1997-9587 3. BIR Tax Identification No. 005-338-421-000

4. Citystate Savings Bank, Inc.
Exact name of issuer as specified in its charter

5. Makati City, Metro Manila, Philippines
Province, country or other jurisdiction of incorporation

6. (SEC Use Only)
Industry Classification Code:

7. Citystate Centre Building, 709 Shaw Boulevard, Pasig City 1600
Address of principal office Postal Code

8. (632) 470-3333
Issuer's telephone number, including area code

9. N/A
Former name or former address, if changed since last report

10. Securities registered pursuant to Sections 8 and 12 of the SRC or Sections 4 and 8 of the RSA

Title of Each Class	Number of Shares of Common Stock Outstanding and Amount of Debt Outstanding
Common Shares	72,764,998

11. Indicate the item numbers reported herein: Item Nos. 4 and 9

Item 1. Changes in Control of Issuer

NOT APPLICABLE

Item 2. Acquisition or Disposition of Assets

NOT APPLICABLE

Item 3. Changes in Issuer's Certifying Accountant

NOT APPLICABLE

Item 4. Resignation, Removal or Election of Registrant's Directors or Officers

In the Stockholders' Meeting of Citystate Savings Bank, Inc. held today, the stockholders elected the following as the members of its Board of Directors for the period 2017 - 2018, to hold office as such and until their respective successors are duly elected and qualified:

Mr. D. Alfred A. Cabangon
Mr. Alfonso G. Siy
Mr. Benjamin V. Ramos
Mr. D. Arnold A. Cabangon
Mr. J. Wilfredo A. Cabangon
Engr. Feorelio M. Bote
Dr. Ramon L. Sin
Atty. Emmanuel R. Sison
Mr. Pedro E. Paraiso
Ms. Susan M. Belen
Mr. Michael F. Rellosa
Mr. Lucito L. Sioson (Independent Director)
Justice Jose Armando R. Melo (Independent Director)
Mr. Wilfredo S. Madarang, Jr. (Independent Director)

Item 5. Legal Proceedings

NOT APPLICABLE

Item 6. Changes in Securities

NOT APPLICABLE

Item 7. Defaults Upon Senior Securities

NOT APPLICABLE

Item 8. Change in Fiscal Year

NOT APPLICABLE

Item 9. Other Events

In the Organizational Meeting held immediately after the Stockholders' Meeting, the Board unanimously elected the following as the corporate officers of CSB for the period 2017 – 2018, to hold office as such and until their respective successors are duly nominated, elected and qualified, to wit:

Mr. D. Alfred A. Cabangon	-	Chairman of the Board
Mr. Alfonso G. Siy	-	Vice Chairman
Mr. Benjamin V. Ramos	-	President
Mr. D. Arnold A. Cabangon	-	Corporate Treasurer
Atty. Socrates M. Arevalo	-	Corporate Secretary
Atty. Atty. Eduardo L. de Jesus	-	Assistant Corporate Secretary

The Board also constituted the following committees pursuant to CSB's Manual on Corporate Governance.

A. EXECUTIVE COMMITTEE

CHAIRMAN	:	Mr. D. Alfred A. Cabangon
MEMBERS	:	Mr. Benjamin V. Ramos
		Mr. D. Arnold A. Cabangon

B. NOMINATION COMMITTEE

CHAIRMAN	:	Mr. D. Alfred A. Cabangon
MEMBERS	:	Mr. Alfonso G. Siy
		Mr. Benjamin V. Ramos
		Ms. Sharon T. Enriquez, HR Department Head (non-voting member)

C. COMPENSATION AND REMUNERATION COMMITTEE

CHAIRMAN	:	Mr. D. Arnold A. Cabangon
MEMBERS	:	Mr. D. Alfred A. Cabangon
		Mr. Benjamin V. Ramos

D. AUDIT COMMITTEE

CHAIRMAN	:	Mr. Lucito L. Sioson, Independent Director
MEMBERS	:	Engr. Feorelio M. Bote
		Mr. Pedro E. Paraiso
		Mr. Wilfredo S. Madarang, Jr., Independent Director

E. CORPORATE GOVERNANCE COMMITTEE

CHAIRMAN	:	Justice Jose Armando R. Melo, Independent Director
MEMBERS	:	Mr. Benjamin V. Ramos
		Mr. Wilfredo S. Madarang, Jr., Independent Director
		Ms. Susan M. Belen

F. RISK OVERSIGHT COMMITTEE

CHAIRMAN	:	Mr. Michael F. Rellosa
MEMBERS	:	Mr. Wilfredo S. Madarang, Jr., Independent Director
		Atty. Emmanuel R. Sison

G. TRUST COMMITTEE

CHAIRMAN	:	Justice Jose Armando R. Melo, Independent Director
MEMBERS	:	Mr. Benjamin V. Ramos
		Mr. Michael F. Rellosa
		Ms. Susan M. Belen
		Ms. Amerjaphil T. Tugade, Trust Officer

H. RELATED PARTY TRANSACTIONS COMMITTEE

CHAIRMAN	:	Mr. Wilfredo S. Madarang, Jr., Independent Director
MEMBERS	:	Justice Jose Armando R. Melo, Independent Director
		Atty. Emmanuel R. Sison

I. INFORMATION TECHNOLOGY STEERING COMMITTEE

CHAIRMAN	:	Ms. Susan M. Belen
MEMBERS	:	Engr. Feorelio M. Bote
		Mr. Benjamin V. Ramos
		Mr. Jeffrey B. Domingo, IT Department Head

J. LOAN COMMITTEE

CHAIRMAN	:	Mr. D. Alfred A. Cabangon
MEMBERS	:	Mr. J. Wilfredo A. Cabangon
		Mr. Benjamin V. Ramos
		Mr. D. Arnold A. Cabangon

Item 10. Financial Statements and Exhibits
NOT APPLICABLE

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

CITYSTATE SAVINGS BANK, INC.
....
Issuer

BENJAMIN V. RAMOS / PRESIDENT
....
Signature and Title*

Date 05/30/2017

* Print name and title of the signing officer under the signature.

REPUBLIC OF THE PHILIPPINES)
MAKATI CITY, METRO MANILA

ANNEX C

CORPORATE SECRETARY'S CERTIFICATION

I, **Atty. Socrates M. Arevalo**, of legal age, Filipino, and with office address at the 2nd Floor, Citystate Centre, 709 Shaw Boulevard, Pasig City, after having been duly sworn in accordance with law, hereby certify that:

1. I am the Corporate Secretary of **Citystate Savings Bank, Inc.** (the "Corporation"), a corporation duly organized and existing under the laws of the Republic of the Philippines, with business address at Citystate Centre, 709 Shaw Boulevard, Pasig City.

2. I hereby certify, to the best of my knowledge and based on available documents, that the following is a complete list of the meetings of the Corporation's Board of Directors for the year 2016 - 2017 and the corresponding names of the Directors of the Corporation who participated in the said meetings:

DIRECTORS	***2016***							***2017***					***PERCENTAGE OF ATTENDANCE***
Name	**JUL 5**	**JUL 26**	**SEP 6**	**SEP 27**	**OCT 25**	**NOV 29**	**DEC 19**	**JAN 31**	**FEB 28**	**APR 6**	**APR 25**	**MAY 30**	
D. ALFRED A. CABANGON	√	√	√	X	√	X	√	√	√	X	√	√	75.00%
ALFONSO G. SIY	X	√	√	X	X	√	√	√	√	X	X	√	58.33%
BENJAMIN V. RAMOS	√	√	X	√	√	√	√	√	√	√	√	√	91.67%
D. ARNOLD A. CABANGON	X	√	X	X	X	√	√	√	X	√	√	√	58.33%
FEORELIO M. BOTE	√	√	X	√	√	√	√	√	X	X	√	√	75.00%
RAMON L. SIN	√	√	X	X	√	√	√	√	√	√	√	√	83.33%
LUCITO L. SIOSON	√	√	√	√	√	√	√	√	√	√	√	√	100.00%
J. ANTONIO A. CABANGON, JR.	√	X	√	X	√	X	*R*	*R*	*R*	*R*	*R*	*R*	50.00%
PEDRO E. PARAISO	√	√	√	√	X	√	√	√	√	√	√	X	83.33%
ATTY. EMMANUEL R. SISON	√	√	√	√	X	√	√	√	√	√	√	√	91.67%
JUSTICE JOSE ARMANDO R. MELO	√	√	√	√	√	√	√	√	√	√	√	√	100.00%
WILFREDO S. MADARANG, JR.	X	√	√	√	√	X	√	√	√	√	√	√	83.33%
J. WILFREDO A. CABANGON	√	√	√	√	X	X	√	√	√	X	X	X	58.33%
SUSAN M. BELEN	√	X	√	√	√	√	√	√	√	√	√	√	91.67%
MICHAEL F. RELLOSA	-	-	-	-	-	-	-	√	√	√	X	√	80.00%

Legend: (√) Present; (X) Absent (R) Resigned

3. I further certify that, in accordance with Subsection X141.1 of the Manual of Regulations for Banks, as amended, in all meetings of the board of directors conducted through teleconferencing, all the directors who took part in said meetings actively participated in the deliberations on matters taken up therein, and that all the directors were given the agenda materials prior to the meeting and that their comments/decisions thereon were submitted for deliberation/discussion and were taken up in the actual board meeting.

4. This certificate is issued in compliance with the reportorial requirements of the Securities and Exchange Commission, to attest to the truth of the foregoing facts, and for whatever legal purpose it may serve.

IN WITNESS WHEREOF, I have hereunto set my hand this JUN 1 3 2017 in ~~Pasig City~~ MAKATI CITY, METRO MANILA.

ATTY. SOCRATES M. AREVALO
Corporate Secretary

SUBSCRIBED AND SWORN to before me this JUN 1 3 2017, affiant exhibited to me his TIN 123-271-382.

EDUARDO DE JESUS
Notary Public
Docket No. M-134 (2017-2018)
Until December 31, 2018
2232 Don Chino Roces Avenue, Makati City, MM.
IBP Life Member # 010568 (2.3.12)
PTR # 5909049 (Makati City, 1.03.17)
MCLE Compliance # V-0011417 (11.02.2015)
Attorney's Roll No. 35993

Doc. No. 414
Page No. 84
Book No. 2;
Series of 2017.

ANNEX D

CITYSTATE SAVINGS BANK
2^{ND} Floor, Citystate Centre
709 Shaw Boulevard, Pasig City

MINUTES OF THE ANNUAL STOCKHOLDERS' MEETING
Held on May 30, 2017 at 9:00 A.M.
At the 20^{th} Floor, Citystate Centre Building
709 Shaw Boulevard, Pasig City

I. CALL TO ORDER

The Chairman, Mr. D. Alfred A. Cabangon, called the meeting to order at 9:00 A.M.

II. PROOF OF REQUIRED NOTICE OF MEETING

The Corporate Secretary, Atty. Socrates M. Arevalo, certified that the Notice of the Annual Stockholders' Meeting was sent to all stockholders in good standing fifteen (15) business days prior to the date of the meeting as required under paragraph (3) (C) of SRC Rule 20.

III. DETERMINATION OF QUORUM

The Corporate Secretary, Atty. Socrates M. Arevalo, announced that the total stockholders physically present and/or represented by proxies sufficiently met the required quorum for the conduct of the meeting.

IV. READING AND APPROVAL OF THE MINUTES OF THE 2016 ANNUAL STOCKHOLDERS' MEETING

Mr. Benjamin V. Ramos, President, took notice of the fact that the copies of the Minutes of the Stockholders' Meeting held on May 31, 2016 have been previously distributed to the stockholders, and thus, he moved that the reading of the minutes be dispensed with and that the same be approved as circulated.

Atty. Emmanuel R. Sison, Director, seconded the motion.

There being no objection, the Minutes of the Annual Stockholders' Meeting of 2016 were noted and approved.

V. CONSIDERATION OF THE PRESIDENT'S REPORT ON THE RESULT OF THE CORPORATION'S OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2015 AND THE 2015 FINANCIAL STATEMENTS

The President, Mr. Benjamin V. Ramos, presented to the stockholders the report on the results of the corporation's operations for the year ended December 31, 2016 and the audited financial statements of the corporation for the year ended December 31, 2016.

Engr. Feorelio M. Bote, Director, moved that the President's Report on the result of the operations of the corporation for the year ended December 31, 2016 and the audited financial statements for the same period be noted and approved.

Atty. Emmanuel R. Sison, Director, seconded the motion. There being no objections, the Chairman, Mr. D. Alfred A. Cabangon concluded that the President's Report on the results of operations of the Corporation for the year ended December 31, 2016 and the audited financial statements for the same period be noted and approved.

VI. RATIFICATION OF ACTIONS TAKEN BY THE BOARD OF DIRECTORS, THE RELATED PARTY TRANSACTIONS COMMITTEE, THE DULY CONSTITUTED COMMITTEES, THE MANAGEMENT AND THE OFFICERS OF THE CORPORATION SINCE THE LAST ANNUAL MEETING OF THE STOCKHOLDERS

The Chairman, Mr. D. Alfred A. Cabangon, sought the confirmation and ratification of the resolutions and the acts of the Board of Directors, the acts of the Related Party Transactions Committee and the duly constituted committees, the acts of the Management, and the acts of the officers of the Corporation since the last Annual Meeting of the stockholders on May 31, 2016.

Atty. Emmanuel R. Sison moved that all the acts and proceedings of the Board of Directors, the Related Party Transactions Committee and the duly constituted committees, the acts of management and the acts of the officers of the corporation, up to the date of this meeting be, in all respects, confirmed, ratified and approved and that the directors, officers and employees of the corporation be commended for the satisfactory results of its operations for the year 2016.

The President, Mr. Benjamin V. Ramos, seconded the motion; there being no objections thereto, the motion was approved.

VII. ELECTION OF DIRECTORS

The Chairman, Mr. D. Alfred A. Cabangon, announced the election of directors of the corporation for the ensuing year and until the next election.

The following were nominated as directors:

Mr. D. Alfred A. Cabangon
Dr. Ramon L. Sin
Mr. D. Arnold A. Cabangon
Mr. Michael F. Rellosa
Mr. J. Wilfredo A. Cabangon
Engr. Feorelio M. Bote
Mr. Alfonso G. Siy
Mr. Benjamin V. Ramos
Mr. Pedro E. Paraiso
Atty. Emmanuel R. Sison
Ms. Susan M. Belen
Mr. Lucito L. Sioson (Independent Director)
Justice Jose A.R. Melo (Independent Director)
Mr. Wilfredo S. Madarang, Jr. (Independent Director)

The stockholders present unanimously voted all the nominees to seat as director for a term of one (1) year or until their successors shall have been elected.

There being no other nominations, the nominations were closed on motion duly seconded and the unanimous vote of the stockholders present in favor of those nominated. Whereupon, the Chairman, Mr. D. Alfred A. Cabangon, declared all the above-named individuals as duly elected directors of the company for the ensuing year and until the election and qualification of their successors.

VIII. APPOINTMENT OF INDEPENDENT AUDITOR

The President, Mr. Benjamin V. Ramos, moved that the Board of Directors be authorized and empowered to appoint the external auditor of the company for the year 2017, as well as to determine the terms of the engagement thereof.

Atty. Emmanuel R. Sison seconded the motion; there being no objections thereto, the motion was approved.

IX. APPROVAL OF THE SUBSCRIPTION OF AMB. ALC HOLDINGS AND MANAGEMENT CORPORATION (AAHMC) TO 18,000,000 SHARES OF CITYSTATE SAVINGS BANK, INC. (CSBI)

The President, Mr. Benjamin V. Ramos, moved that the subscription by AMB. ALC HOLDINGS AND MANAGEMENT CORPORATION (AAHMC) to 18,000,000 shares of the corporation, which subscription had earlier been approved by the Board of Directors in its meeting held last December 19, 2016, be likewise approved by the stockholders of the corporation, in compliance with the rules of the Philippine Stock, Exchange (PSE) on additional listings.

Atty. Emmanuel R. Sison seconded the motion; there being no objections thereto, the following Resolution was adopted:

RESOLUTION

> ***RESOLVED,*** *that the Resolution of the Board of Directors of CITYSTATE SAVINGS BANK, INC., approved and adopted during the Board Meeting of December 19, 2016, whereby the Board of Directors accepted the offer of AMB. ALC HOLDINGS AND MANAGEMENT CORPORATION to subscribe to eighteen million (18,000,000) shares of stock of CITYSTATE SAVINGS BANK, INC., with a par value of Ten Pesos (PhP 10.00) per share, or an aggregate par value of One Hundred Eighty Million Pesos (PhP 180,000,000.00) be as it is hereby approved.*

Thereafter, upon motion by Director Feorelio M. Bote, on behalf of the corporation's minority stockholders, which motion was duly seconded by Director Alfonso G. Siy, the requirement to conduct a rights or public offering of the shares subscribed was waived. The following Resolution was adopted:

RESOLUTION

> ***RESOLVED,*** *that with the consent of the majority of the minority stockholders of CITYSTATE SAVINGS BANK, INC. having been favorably obtained, the requirement to conduct a rights or public offering of the eighteen million (18,000,000) shares of stock of CITYSTATE SAVINGS BANK, INC., with a par value of Ten Pesos (PhP 10.00) per share, or an aggregate par value of One Hundred Eighty Million Pesos (PhP 180,000,000.00), which were issued from the unsubscribed portion of the authorized capital stock of CITYSTATE SAVINGS BANK, INC. and which will be subscribed and purchased by AMB. ALC HOLDINGS AND MANAGEMENT CORPORATION, be as it is hereby waived.*

X. OTHER MATTERS

The Corporate Secretary, Atty. Socrates M. Arevalo, said that there are no other matters to be taken up.

XI. SCHEDULE OF THE BOARD MEETING

Based on the provisions of the By-laws of the corporation, the stockholders delegated the fixing of the schedule of the Board of Directors meeting, as it may deem fit and necessary.

XII. ADJOURNMENT

The meeting was adjourned at 9:35 A.M.

ATTY. SOCRATES M. AREVALO
Corporate Secretary

ATTY. EDUARDO L. DE JESUS
Assistant Corporate Secretary

CHARTER OF THE RELATED PARTY TRANSACTION

The Citystate Savings Bank, Inc., in compliance with the circulars and guidelines issued by the Bangko Sentral ng Pilipinas wish to institutionalize the existence of the Related Party Transaction Committee as a Board level committee with specific objectives and/or purpose to exercise appropriate oversight and implement effective control systems for managing all related party transactions that these are done on an arm's length basis.

WE, the Board of Directors of Citystate Savings Bank, Inc. resolved, as we hereby resolve, to adopt the following Related Party Transaction Committee Charter, to wit:

ARTICLE I. GENERAL PROVISIONS

Section 1. *Title* - This document shall be known and cited as the "Related Party Transaction Committee Charter" (RPTC).

Section 2. *Applicability* - This Charter shall apply to all office , departments and/or units of the Bank mandated to propose and/or implement policies of the Bank on all related party transactions such as: (a). Purchases, sales or supply of any goods or materials; (b). Borrowings, commitments, fund transfers and guarantees; (c). Construction arrangements/contracts; (d). Lease arrangements/contracts; (e). Finance (including credit accommodations and equity contributions in cash or in kind); (f). Consulting, professional, agency and other service arrangements/contracts; (g). Establishment of joint venture entities; (h). Trading and derivative transactions and (i). Purchases and sales of assets, including transfer of technology and intangible items (e.g. research and development, trademarks and license agreements).

Section 3. *Repeal Clause* - This Related Party Transactions are generally allowed provided, that these are done on an arm's length basis. This charter shall be in full force and effect unless expressly repealed by subsequent policy enactments duly approved by the Board of Directors.

Section 4. *Effectivity* - This Charter shall take effect immediately upon approval of the Board of Directors.

ARTICLE II. THE RELATED PARTY TRANSACTION COMMITTEE

Section 1. Composition - There is hereby constituted a board-level Related Party Transaction Committee (RPTC) composed of at least three (3) Board of Directors, two (2) of which must be an Independent Director including the Chairperson.

The Related Party Transaction Department (RPT Dept.) shall serve as the secretariat and custodian of minutes and/or resolutions of the Committee.

As such, the RPT Department shall conduct preliminary review of related party transaction proposals submitted by proponent units and regularly report to the RPTC the results of such RPT review and related matters.

Section 2. Qualification, Disqualification and Succession - All members shall be directors of the bank. Any member or chairperson who is removed from office, either by resignation or termination, shall be automatically disqualified as member or chairperson on the effective date of his/her resignation or termination. In case of resignation or termination of any or all of the regular members. of the Committee, their replacements, shall automatically be members.

Section 3. Quorum - The attendance of the majority of the members shall constitute quorum.

Section 4. Meetings - The Committee shall meet as needed, or, at least quarterly meeting to convene, discuss and prepare recommendations and reports or in such date or time designated by the Chairperson, at the bank's Conference Room located at the second floor, Citystate Bldg. Centre, 709 Shaw Blvd., Oranbo, Pasig City. Provided, the Chairperson or the Vice-Chairperson may call special meetings specifying to discuss urgent matters or issues arising prior to the scheduled quarterly meeting.

Section 5. Powers of the RPT COMMITTEE - The RPT Committee shall have the following powers, to wit:

a). Review and evaluate all related party transactions including the on going basis existing relations between and among businesses and counterparties to ensure that all related parties are continuously identified and monitored and subsequent changes in relationships with counterparties are captured;

b). Evaluate and determine all material RPTs to make sure that these transactions are not undertaken on more favorable economic terms (such as: price, fees, interest rates, tenor or collateral requirements) and no corporate or business resources of the bank are misappropriated or misappllied;

c). Determine any potential reputational risk issues that may arise as a result of or in connection with the transactions; In evaluating RPT's, the RPTC shall take into account and identify the following:

(c.1). the related party's relationship to the bank and interest in the transaction;
(c.2). the material facts of the proposed RPT, including the aggregate value of of such transaction;
(c.3). the benefits to the bank of the proposed RPTs;
(c.4). the availability of other sources of comparable products or services;
(c.5). an assessment of whether the proposed RPT is on terms and conditions the bank shall have an effective price and must exercise due diligence.

d). Ensure that transactions with RP (including write-off of exposures) are subject to periodic independent review or audit process.

e). Ensure that all appropriate disclosure is made and shall include information on the approach to managing material conflicts of interest that are inconsistent with the policies.

f). Report to the BOD on a regular basis, the status and aggregate exposures to each related party as well as the total amount of exposures to all related parties.

g). Oversee the implementation of the system for identifying, monitoring, measuring, controlling and reporting RPTs, including the periodic review of RPT policies the periodic review of RPT policies and procedures.

Section 6. Voting/Decision - The committee shall act collectively on all matters or issues affecting bank's compliance with rules and existing laws to manage and monitor all related party transactions to be done on an arm's length basis. Any member or individual not in conformity with the majority decision may submit written dissent or comment to the Chairperson. The dissent or comment, if found meritorious by the Chairperson, may be presented on the next regular or special meetings for consideration to the majority.

Section 7. Reporting - The RPT Committee shall be reporting to the Board of Directors.

Adopted this 22nd day of February 2016 at Pasig City, Philippines.

AMB. ANTONIO L. CABANGON-CHUA
Chairman of the Board

MR. ALFONSO G. SIY
Vice Chair

MR. BENJAMIN V. RAMOS
Director/President

MR. J. ANTONIO A. CABANGON, JR.
Director

MR. D. ARNOLD A. CABANGON
Director

MR. D. ALFRED A. CABANGON
Director

DR. RAMON L. SIN
Director

ENGR. FEORELIO M. BOTE
Director

MR. PEDRO E. PARAISO
Director

JUSTICE JOSE ARMANDO R. MELO
Independent Director

ATTY. EMMANUEL R. SISON
Director

MR. LUCIITO L. SIOSON
Independent Director

MR. WILFREDO S. MADARANG, JR.
Independent Director

MR. J. WILFREDO A. CABANGON
Director

THE GENERAL POLICY STATEMENT OF RELATED PARTY TRANSACTION

(Revised as of Sept. 20, 2017)

CITYSTATE SAVINGS BANK

1). **INTRODUCTION**:

In accordance with the regulations, policies and guidelines on Corporate Governance issued by Bangko Sentral ng Pilipinas (BSP), the Securities and Exchange Commission (SEC) and other regulatory bodies, Citystate Savings Bank recognizes the need to strengthen its policy on related party transactions and other similar situations so as to prevent or mitigate abusive transactions with related parties and avoid risks of conflict of interest.

On 13 November 2015, the Monetary Board (MB), in its Resolution No. 1903 approved the guidelines strengthening oversight and control standards for managing Related Party Transactions (RPTs).

As per BSP Circular No. 895 policy statement, the BSP guidelines on Related Party Transactions recognizes that transactions between and among related parties create financial, commercial and economic benefits to individual institutions and to the entire group where said institutions belong. This guidelines are designed to ensure that banks exercise appropriate oversight and control over their RPTs as well as for alignment with the effective control systems for managing said exposure. In this regard, related party transactions are generally allowed provided, that these are done on an arm's length basis.

CITYSTATE SAVINGS BANK recognizes that certain relationships can present potential or actual conflicts of interest and may raise questions about whether transactions associated with such relationships are consistent with ***CITYSTATE SAVINGS BANK's*** general policies and its stakeholders.

11). **OBJECTIVES:**

The Related Party Transaction Policy sets out to achieve the following:

- To formulate policies and procedures that would ensure the integrity and transparency of related party transactions for the approval of the RPT Committee or Board of Directors;

- To implement the general requirements as approved by the RPT COMMITTEE and Board of Directors;

- To adopt and approve a group-wide Related Party Transaction (RPT) Policy which shall encompass all entities within the banking group.

- To effectively identify, manage and monitor RPTs on a per transaction and aggregate basis.

- To ensure that RPTs are within prudent levels, the policy shall include consolidation of all existing policies that address the reportorial requirements or may make reference to already existing policies.

111). **TERMS AND DEFINITIONS:**

3.1 **RELATED PARTIES** - the policy shall clearly define "Related Parties". This shall cover the bank's subsidiaries as well as affiliates and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts direct/indirect control over or that exerts direct/indirect control over the bank; the bank's **D**irectors; **O**fficers; **S**tockholders; and Related Interest (DOSRI), and their close family members, as well as corresponding persons in affiliated companies. This shall also include such other person/juridical entity whose interest may pose potential conflict with the interest of the financial institution (FI), hence, is identified as a RELATED PARTY.

3.2 **RELATED PARTY TRANSACTIONS -** this are transactions or dealings with related parties of the bank/FI; or any financial transaction, arrangement or relationship between the company and any related party for a transfer of resources , services or obligations , regardless of whether or not a price is charged.

3.3 **CLOSE FAMILY MEMBERS -** this refers to the person's related to the bank's **D**irectors, **O**fficers and **S**tockholders (DOS) within the second degree of consanguinity or affinity, legitimate or common-law. These shall include the spouse, parent, child, brother, sister, grandparents, grandchild, parent-in law; son/daughter-in law, brother/sister-in law of the FI's and DOS.

3.4 **CONSANGUINITY** - this shall define as with the same blood relationship, descended from the same ancestor (e.g. grandmother, granddaughter, grandchild).

3.5 **AFFINITY** - this is defined as relationship by-law (thru marriage), kinship (e.g. Sister/brother-in law, grandfather/grandmother-in law and or common law).

3.6 **DOSRI** - this shall refer to the related interest (RI) limited to 1ST degree relatives of the Directors, Officers, Stockholders and related interest and their close family members as well as the corresponding persons in affiliated companies.

3.7 **SUBSIDIARY -** a corporation more than fifty percent (50%) of the voting stock of which is owned or controlled directly or indirectly through one (1) or more intermediaries.

3.8 **AFFILIATE** - a juridical person that directly or indirectly, through one (1) or more intermediaries, is controlled by, or is under common control with the bank or its affiliates.

3.9 **CORRESPONDING PERSONS IN AFFILIATED COMPANIES -** this refers to the Directors, Officers and Stockholders (DOS) of the affiliated companies and their close family members.

3.10 **MATERIALITY THRESHOLD** - refers to any financial transaction, arrangement or relationships in which: **a)**. the aggregate amount involved will or may exceed Php1.0M in any fiscal year;
b). where the company is a participant; and
c). the related party has or will have a direct or indirect material interest.

1V). **<u>IDENTIFIED RELATED PARTIES</u>**:

- ✓ DOSRI (RI limited to 1ST degree relatives);
- ✓ A Director of the bank and its subsidiaries, affiliates' "director" or a stockholder owning at least 1% or more;
- ✓ Key Officers of the bank (senior officer) and its subsidiaries and affiliates' with the rank of an "AVP" and up;
- ✓ Close Family Members of DOS (2nd degree relatives) or an immediate family member of Directors, Officers and Stockholders;
- ✓ A Corresponding Person in Affiliated Companies/other person/ juridical entity whose interest may pose potential conflict with the interest of the Financial Institution (FI);
- ✓ Any outstanding transactions entered into with an unrelated party that subsequently becomes a Related Party (RP);
- ✓ Any transactions directly or indirectly involving any Related Party that would be required to be disclosed or any currently proposed transactions involving the company, including joint ventures in which **the amount involved will or may exceed PHP1.0M.**

<u>WHO ARE CONSIDERED BANK's/FI's RELATED PARTIES?</u>

For the purposes of this policies, a Party is related when classified as:

4.1 DOSRI

- ALC Group of Companies
- Directors
- Officers
- Stockholders
- Related Interest (RI up to the first degree of DOS)

4.2 Close Family Members of DOS up to the second degree of consanguinity & affinity;

4.3 Corresponding Persons in Affiliated Companies with the rank of an "AVP" and up;

4.4 Any person/juridical entity whose interest may pose potential conflict with interest of the bank.

V). **<u>IDENTIFIED RELATED PARTY TRANSACTIONS:</u>**

- ✓ Finance (including: Credit accommodations and equity contributions in CASH or in kind);
- ✓ Purchases, and sales of assets, supply of goods or materials, including transfer of technology and Intangible items (e.g. Research and development, trademarks);
- ✓ Consulting, professional, agency and other service arrangements/contracts;
- ✓ Agency agreements; License Agreements;
- ✓ Investments and/or subscriptions for debt/equity issuances;
- ✓ Leasing of property of any kind (lease arrangements / contracts);
- ✓ Outsourcing arrangements;
- ✓ Selling or disposing of, or buying property of any kind;
- ✓ Borrowings, commitments, fund transfers, guarantees, sureties and investments;
- ✓ Management contracts/ establishment of joint venture entities;

For the purposes of this policies, a related party transaction is any transfer of resources, services or acceptance of obligations between related parties, regardless whether any compensation has been agreed upon.

V1). **THE RELATED PARTY TRANSACTIONS INCLUDES THE FOLLOWING:**

6.1 **SALE OF ASSETS INCLUDING ROPA TO RELATED PARTY:**
(Minimum contents of Related Party Transaction Proposals)

- ✓ Name of Related Party Buyer (identify relationships with the bank);
- ✓ Selling Price;
- ✓ Interest Rate, repayment period, collateral (if sale by installment);
- ✓ Price discovery mechanism employed (including appraised values) (e.g. Public/private bidding);
- ✓ Background and description of the asset;
- ✓ Other material terms and conditions (including deviations from the policy);
- ✓ Terms generally granted on similar transactions to similarly-situated buyers.

6.2 **GRANT OF LOANS TO RELATED PARTY TRANSACTIONS:**
(Minimum contents of Related Party Transactions Proposals)

- ✓ Name of Related Party Borrower (identify relationship with the bank);
- ✓ Risk Rating of Borrower;
- ✓ Amount of Loan, actual interest rate, repayment period and collateral;
- ✓ Prevailing market rates for similar loans;
- ✓ If collateral is deposit (interest rate on deposits);
- ✓ Other material terms and conditions (including deviations from the policy);
- ✓ Total exposure of the borrower/related borrowers;
- ✓ Terms generally granted to similarly-situated borrowers.

V11). **GENERAL POLICY STATEMENT**:

Guided by the firm commitment to integrity, ***CITYSTATE SAVINGS BANK*** ensures the fairness and transparency of related party transactions between and among the corporation and its parent company, joint ventures, subsidiaries, associates, affiliates, major stockholders, officers and directors, including their spouses, children and dependent siblings and parents and of interlocking director relationships by members of the board.

It is the bank policy that any transaction involving related parties must be conducted at an arm's length with any consideration paid or received by the bank or any of its subsidiaries in connection with any such transaction being on terms no less favorable to the bank than terms available to any unrelated party under the same or similar circumstances must be done with the best interest of ***CITYSTATE SAVINGS BANK*** in mind.

V111). **POLICY GUIDELINES:**

8.1 The management represents that the bank shall enter into Related Party Transactions **in the ordinary course of business; done on an arm's length basis and with the best interest of the bank.**

8.2 All material Related Party Transactions (RPT)shall require approval of the Board of Directors through special resolution and the related parties shall abstain from voting on such resolution.

8.3 All Related Party Transactions in excess of the limits, which are not in the ordinary course of business or not at arm's length basis shall also require prior approval of the board and related parties shall abstain from voting on such resolution.

8.4 In determining whether to approve, ratify or disapprove or reject a Related Party Transaction, the RPT Committee as appropriate, shall take into account among other factors it deems appropriate whether the RPT is entered into on terms no less favorable to the company than to terms generally available to an unaffiliated third-party under the same or similar circumstances; whether there was a bidding process and the results thereof; review of the valuation methodology used and alternative approaches to valuation of the transaction and the extent of the related person's interest in the transaction.

8.5 The policy applies to any transaction, arrangement or relationship in which the aggregate amount involved will or may exceed PHP1.0M in any fiscal year where a related party has or will have direct or indirect material interest.

1X). **EXEMPTIONS ON MATERIALITY THRESHOLD AND EXCLUDED TRANSACTIONS:**

This policy may or shall identify transactions excluded from the materiality threshold requirement such as:

9.1 Deposit operations;

9.2 Regular Trade Transactions involving purchases and sales of debt equity;

9.3 The Fringe benefit programs granted and approved by the BSP;

9.4 Branches shall be exempted in handling any Related Party Transactions excluding Chino Roces and Head Office Branch. All proposed Related Party Transactions shall be referred to or report directly to the RPT Dept. for proper evaluation and verification of the proposed RPT;

9.5 The ordinary course transactions shall be applied on terms equivalent to market or standard terms.

9.6 Any financial services including banking services and other financial services provided by the bank to any director or any immediate family member of a director, provided that the services are on substantially the same terms as those prevailing at the time for comparable services provided to non-affiliates.

9.7 Any exceptions to the policy on Related Party Transactions must be consistent with the act, including any regulations promulgated thereunder, and must be with prior approval of the Board of Directors (BOD).

X). **REVIEW AND APPROVAL OF RELATED PARTY TRANSACTIONS**:

In determining whether to approve or ratify a Related Party Transaction, the Committee will consider the following factors, among others, to the extent relevant to the Related Party Transactions:

10.1 Any financial transaction, arrangement or relationship in which the aggregate amount involved **will or may exceed PHP1.0M** in any fiscal year where a Related Party has or will have direct or indirect material interest.

10.2 Key Officers of the bank and its affiliates (senior officers) with the rank of Asst. Vice President (AVP) and up, and who has a direct or indirect material interest.

10.3 Whether the terms of the Related Party Transactions are FAIR to the company and would apply on the same basis if the transaction did not involve a Related Party.

10.4 Whether there are many compelling business reasons for the company to enter into the Related Party Transaction and the nature of alternative transactions, if any.

10.5 To review a Related Party Transaction, the Committee will be provided with all the relevant material information of the Related Party Transaction, including the terms of the transaction, the business purpose of the transaction, the benefits to the company and to the Related Party, and any other relevant matters.

10.6 To ascertain that the transaction is at arm's length and in the ordinary course of business.

10.7 In case of material related party transactions (materiality threshold), the transaction shall require approval of the Board of Directors through special resolution.

X1). **<u>PROCEDURES IN MONITORING RELATED PARTY TRANSACTIONS</u>:**

All departments/units with RPT shall report any possible transaction or any proposed related transactions involving related parties with direct or indirect material interest regardless of the amount. RPT Department shall identify all Related Parties for the bank on the basis of disclosures received from each department/unit, investment structures and other related supporting documents or information on a weekly basis and every end of the month. The RPT Secretariat shall arrange/consolidate all transaction reports identified as Related Parties to obtain RPT COMMITTEE's final evaluation and endorsement prior to board approval.

While obtaining the final evaluation and endorsement, the following would be ensured:

- Provide relevant details of the proposed transactions via written request with complete and significant justifications;
- Evaluate whether the RPT would present a conflict of interest for any Related Party of the bank;
- To ascertain that the transaction is at arm's length basis; in the ordinary course of business and with the best interest of the bank;
- In case of material transaction (threshold), the transaction needs to be referred to the Board of Directors (BOD) for approval.

X11). **<u>DATABASE OF RELATED PARTIES</u>**:

The Related Parties of CITYSTATE SAVINGS BANK are included and arranged in a special database (herein referred to as the **"RPT TRACKER")** which the bank maintains on the basis of information in its possession and of the statements received from direct related parties. The RPT TRACKER must be updated at least every six (6) months in order to be consistent in the reportorial system.

- Direct Related Parties shall promptly give notice to the RPT Dept. or HRD Head of any new parties that are related to them;
- The RPT Tracker will serve as the basis for the branches to perform proper tagging of the Related Party accounts base on the classification of accounts;
- The RPTD shall supervises the proper updating of the DATABASE, through periodic audits carried out with the assistance of the internal Audit.

(Note: Attached is the sample of the RPT TRACKER Form – Exhibit 1.1)

X111). **<u>REPORTORIAL PROCEDURES OF RPT VIA RPT TRACKER:</u>**

- All departments/units with Related Party Transactions are required to submit their weekly and monthly reports to RPTD on or before the scheduled dates which is every Monday of the following week;
- The RPT Weekly Report shall cover the previous transactions of the initiating department or units regardless of the amount involved or type of related party transactions with the Related Parties;
- All RPT Reports shall be submitted to RPT Dept. for review to determine all relevant facts and circumstances including the terms and conditions;
- In case of no related party transactions for the week, **<u>STILL,</u>** the concern department or unit is required to submit the weekly report and shall indicate the following:

"**<u>NONE TO REPORT"</u>**

- All department heads or unit heads with RPT shall be required to affix their signatures on the weekly and monthly report prior to submission of the final report thru EMAIL or scanned document;

- All department heads and unit heads with RPT may or shall identify the next person-in-line to handle RPT. The identified next person-in-line must be knowledgeable in processing and handling RPT including the reporting.

- The identified next person-in-line must be with the rank of an Official Assistant (officer level).

IV). **DISCLOSURE:**

On a quarterly basis, the bank is required to disclose any material Related Party Transactions (RPT) to the regulatory body: Bangko Sentral ng Pilipinas (BSP).

- END -

ANNEX F

PERFORMANCE APPRAISAL FORM

RATEE	:	RATER	:
POSITION	:	POSITION	:
DEPT/BRANCH	:	REVIEW PERIOD	:
DATE HIRED	:	PURPOSE	:

PART I – PERFORMANCE STANDARDS

Department Objective

DELIVERABLES (A)	Target Completion Date (B)	% Weight (C)	Performance Criteria (D) Quantity (1)	Quality (2)	Timeliness (3)	Score (E)	Weighted Score (F)
		40%	20%	50%	30%	0.00	0.00
		10%	20% 0.00	30% 0.00	50% 0.00	0.00	0.00
		10%	20% 0.00	20% 0.00	60% 0.00	0.00	0.00
		10%	20% 0.00	20% 0.00	60% 0.00	0.00	0.00
		20%	20% 0.00	40% 0.00	40% 0.00	0.00	0.00
		10%	10% 0.00	30% 0.00	60% 0.00	0.00	0.00
TOTAL WEIGHT		**100%**					

PART I OVERALL RATING **0.00**

AGREEMENT ON PERFORMANCE COMMITMENT

I fully understand and agree to deliver these work outputs on or before its due date.

As immediate supervisor, I agree to provide full support towards the delivery of these work outputs.

Ratee's Name and Signature

Rater's Name and Signature

Date of Agreement

RATEE	**:**	**REVIEW PERIOD**	**:**

PART II – PROFESSIONAL COMPETENCIES

COMMUNICATION

Ability to listen to others to gain full understanding of issues; comprehend written and verbal instructions; and present information or ideas in a clear and concise manner, verbally or in writing.

BEHAVIORAL INDICATOR	RATING	NOTES	
Creates clear and concise written communication			
Comprehends written and verbal information and direction, and takes appropriate action			
Communicates intentions, ideas, and feelings openly and directly			
Receives and learns from feedback			
Remains respectful when in conflict with others			**#DIV/0!**
Demonstrates professionalism when communicating with others			**AVERAGE**

SERVICE FOCUS

Values and delivers high quality, innovative service to intenal and external customers

BEHAVIORAL INDICATOR	RATING	NOTES	
Actively seeks information to understand customers' circumstances, problems, expectations, and needs			
Recommends solutions to customer needs			
Responds promptly to customer needs			
Addresses customer complaints professionally; and personally follows through to resolve issues			
Uses best practices to develop solutions and respond to customer needs			**#DIV/0!**
Assumes shared accountability for improving delivery of service			**AVERAGE**

TEAMWORK AND COLLABORATION

Cooperates with the team to accomplish department and organizational goals; values the contribution of others

BEHAVIORAL INDICATOR	RATING	NOTES
Consistently works with others to accomplish goals and tasks		
Treats all team members with courteous, and professional manner; supports team despite differences		
Considers views of other team members when analyzing situations and developing solutions		
Works well with different personalities; rarely encounters someone he/she cannot work effectively with		
Keeps commitment to the team to achieve goals and objectives.		**#DIV/0!**
Sensitive to other people's feelings		**AVERAGE**

RATEE	**: Ashley Bernice Courtney S. Topacio**	**REVIEW PERIOD**	**:**

INITIATIVE

Proactively identifies ways to contribute to the Bank's goals and missions; identifies and takes action to address problems and opportunities.

BEHAVIORAL INDICATOR	RATING	NOTES
Completes tasks without the need for prompting from his/her immediate head or other department heads		
Seeks out information on his/her own initiative; follows up with his/her immediate head for direction		
Successfully completes most tasks independently and asks support when faced with unfamiliar tasks or situations		
Generates commitment and enthusiasm from others to set and achieve challenging objectives		
Takes action that goes beyond job requirements in order to achieve goals		**#DIV/0!**
Implements new ideas or potential solutions without prompting; does not wait for others to take action or to request action		**AVERAGE**

MANAGING WORK

Effectively managing time and resources to ensure that work is completed efficiently.

BEHAVIORAL INDICATOR	RATING	NOTES
Identifies more critical and less critical activities and tasks; adjust priorities when appropriate		
Ensures that required equipment and/or materials are in place so that own and others' work can be done effectively		
Effectively allocates own time to complete work; coordinates schedule to avoid conflicts		
Uses time effectively and prevents irrelevant issues or distractions from interfering with work completion		**#DIV/0!**
Uses available resources to complete work efficiently		**AVERAGE**

PROFESSIONAL DEVELOPMENT

Identifies learning areas, and taking advantage of learning opportunities

BEHAVIORAL INDICATOR	RATING	NOTES
Opens self to feedback and uses it to identify his/her learning areas		

Engages in continuous learning opportunities to further develop skills and capabilities			
Applies knowledge, understanding, or skill to practical use on the job; furthers learning through trial and error			
Takes part in professional associations to maintain a current knowledge base and relationship with others in his/her field			
Incorporates industry and government trebds in planning and decision making			**#DIV/0!**
Actively participates in the performance management program with focus on improving performance through learning and development opportunities			**AVERAGE**

RATEE :	**REVIEW PERIOD :**

ORGANIZATIONAL DISCIPLINE

Ability to manifest self-discipline through productive use of time and resources of the Bank

BEHAVIORAL INDICATOR	RATING	NOTES	
Always present at work except on scheduled leaves			
Arrives at work or in meeting on time			
Follows mandated dress code			
Understands and applies Bank's policies and procedures			**#DIV/0!**
Attends organizational activies such as General Assemby, Christmas Party, and similar events			**AVERAGE**

PART II RATING **#DIV/0!**

PART III – SERVICE QUALITY

Please refer to Quality Assurance Report

Mystery Shopper ________
Mystery Caller ________
Client Servicing ________
Commendations/Client Complaints ________

PART III RATING **#DIV/0!**

PART IV – ATTENDANCE AND PUNCTUALITY

Scoring:

Frequency		Score
0		5
1 - 2		4
3 - 4		3
5 - 6		2
7 +		1

Month	LEAVE		ATTENDANCE					PUNCTUALITY		Remarks
	VL	SL	Excess Leave	Unfiled Leave	Undertime	Frequency	Score	Tardiness	Score	
January/July					0	0	5.00	0	5.00	
February/August					0	0	5.00	0	5.00	
March/September					0	0	5.00	0	5.00	
April/October					0	0	5.00	0	5.00	
May/November					0	0	5.00	0	5.00	
June/December					0	0	5.00	0	5.00	
Average Score							5.00		5.00	

PART IV RATING **5.00**

RATEE	: Ashley Bernice Courtney S. Topacio	REVIEW PERIOD	: July - December 2017

PART V – DEVELOPMENT ACTION PLAN

STRENGTHS	DEVELOPMENT NEEDS

ACTION PLAN	BY WHOM	BY WHEN
[X] For Promotion to ________		
[ ] For Transfer to ________		
[ ] For Training on ________		
[ ] Others ________		

FINAL RATING

Performance Factors	Overall Rating	Percentage Weight	TOTAL
Part I – Performance Standards	0.00	50%	0.00
Part II - Professional Competencies	#DIV/0!	20%	#DIV/0!
Part III - Service Quality	#DIV/0!	20%	#DIV/0!
Part IV - Attendance and Punctuality	5.00	10%	0.50
		Final Rating	**#DIV/0!**
		Adjectival Rating	**#DIV/0!**

CONFIRMATION OF PERFORMANCE DISCUSSION

This is to confirm that the results of this performance evaluation for the given appraisal period have been discussed by the rater and the ratee.

Likewise, this is to confirm that the performance discussion covered all performance areas in this form – the Performance Standards, Professional Competencies and its ratings, and the Development Action Plans, and the Performance Commitment for The next appraisal period

Name and Signature of Ratee	**Name and Signature of Rater**	**Department Head**
5/24/2018	5/24/2018	
Date	**Date**	**Date**

Received and Acknowledged by:

HRAD Representative

RATING SCALE

1.49	**-**	**2.49**	**Unsatisfactory**
	1.00		*Performance is consistently below expectations. Employee requires a written performance plan from the immediate head. Excessive time and attention by the immediate head is required to supervise the employee.*
2.50		**2.99**	**Needs Improvement**
	0.49		*Perfomance is somewhat below expectations for full competence, but some elements of satisfactory performance are exhibited.*
3.00	**-**	**3.49**	**Developing Performer**
	0.49		*Performance at this level reflects that the employee is in growth and learning mode in terms of organizational values and/ or job competence.Employees requires support in the form of coaching and feedback to continue making progress.*
3.50	**-**	**4.49**	**Solid Performer**
	0.99		*Performance consistently meets expectations and at times exceeds them in demonstrating organizational*
4.50	**-**	**4.99**	**Exceeds Expectations**
	0.49		*Performance consistently exceeds expectation in most of the organizational values. All requirements*

5.00	**Exceptional Performance**
5.00	*Performance is exceptional. Able to exhibit organizational values.Accomplisjments were made in*

ANNEX G

CITYSTATE SAVINGS BANK
We Take Care of You.

AUDIT COMMITTEE CHARTER

I. - PURPOSE

This Charter is established by the Board of Directors (the"Board") of Citystate Savings Bank, Inc. and the purpose of this Charter is to clearly define the Audit Committee's (the "Committee") qualifications, authority and its duties and responsibilities based on the requirements of SEC's Code of Corporate Governance. The Committee's activities and effectiveness will be assessed annually by the Board. For this purpose, the Board may create an independent Governance Committee to assess the performance of the Committee.

The Committee shall be appointed by the Board of CSBI. Its primary function is to assist the Board in fulfilling its oversight responsibilities by reviewing (1) the financial information, which will be provided to the shareholders and others; (2) the systems of internal controls and risk management which Management and the Board have established; (3) the audit process; (4) the process for monitoring compliance with significant applicable legal, ethical and regulatory requirements, including CSBI's Code of Ethics and (5) such other duties as directed by the Board. In doing so, it is the responsibility of the Committee to provide a free and open avenue of communication among Management, Compliance Officer, Internal Audit, the external auditors, BSP examiners and the Committee. To perform his or her role effectively, each committee member will obtain an understanding of the responsibilities of committee membership as well as the Bank's business, operations and risks.

II.- AUTHORITY

The Committee should have sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of audit reports and appropriate action on audit recommendations. It has authority to conduct or authorize investigations into matters within its scope of responsibility. It is empowered to:

(a) Appoint, compensate and oversee audit engagements performed by BSP accredited external auditing firm employed by CSBI.

(b) Review and comment on all reports issued by internal and external auditors for CSBI as well as those from regulatory bodies like Bangko Sentral ng Pilipinas (BSP), Philippine Deposit Insurance Corporation (PDIC), Securities and Exchange Commission (SEC) and Bureau of Internal Revenue (BIR).

(c) Resolve any disagreements between management and the auditor regarding financial reporting.

(d) Conduct or investigate any matter appropriate to fulfilling its responsibilities with full access to all books, records, facilities and personnel of the Bank and retain independent or outside counsel auditors, accountants or other experts to advise the Committee or assist for this purpose.

(e) Meet with Management, external auditors, regulatory examiners or outside counsel, as necessary.

III. -ORGANIZATION AND QUALIFICATIONS

(a) The Committee shall be appointed annually by the Board.

(b) The Committee shall be composed of at least three (3) but not more than five (5) members of the Board, who do not hold executive positions in the Bank and who are not members of the Executive and Trust Committees of the Bank. The Committee shall also include at least two (2) independent directors, including the Chairman, who are defined as follows:

- is not an officer or employee of CSBI or its affiliates;
- is not a relative of an officer or other employees of SCBI or its affiliates;
- does not hold or control, or has not held or controlled, directly or indirectly, within the preceding year, assets representing 10 percent or more of any outstanding class of voting securities of CSBI; and
- does not have any outstanding extensions of credit from CSBI or its affiliates.

(c) Each members shall have adequate understanding at least, or competence at most, of CSBI's operations, financial management systems and environment and preferably with accounting, auditing or related financial management expertise or experience.

(d) Each member shall be required to attend seminar and training to develop their skills and competencies needed in the discharge of their duties and responsibilities.

IV – MEETINGS

The Committee will meet at least quarterly, with authority to convene additional meetings, as circumstances require and at such times and places as the Committee shall determine. All Committee members are expected to attend each regular and special meetings. The majority of the members of the Committee shall constitute a quorum. The Committee will invite members of management, auditors, compliance officer or others to attend the meetings and provide pertinent information, as necessary. The committee members may meet with the internal and external auditors, as deemed necessary.

It is the responsibility of the Chairman to schedule and preside all meetings of the

Committee. The agenda for Committee meetings will be prepared in consultation between the Committee Chairman (with input from the Committee members) and the Management, Head of Internal Audit Department (IAD), Compliance Officer or the public accounting firm and provided in advance to members, along with appropriate briefing materials. The Audit Committee will maintain written minutes of its meetings, which will be submitted to and confirmed by the Board.

V – RESPONSIBILITIES

The Committee in carrying out its responsibilities believes its policies and procedures should remain flexible, in order to best react to changing conditions and circumstances and ensure that CSBI's internal controls and accounting and financial reporting practices meet all legal requirements and are of the highest quality.

The Committee will carry out the following responsibilities:

A. Financial Statements

1. Review with Management (as deemed necessary with the external auditors) the financial statements and related footnotes before submission to the Board, focusing particularly on:

   (a) any changes/s in accounting policies and practices;
   (b) major judgmental areas;
   (c) significant adjustments resulting from the audit;
   (d) any going concern assumptions;
   (e) compliance with accounting standards and
   (f) compliance with tax, legal and stock exchange requirements

B. Internal Control

1. Monitor and evaluate the adequacy and effectiveness of CSBI's internal control system including information systems and security.

2. Ascertain whether significant findings and recommendations made by internal and external auditors and regulatory bodies have been implemented by management.

C. Risk Management

1. Provide oversight over senior management's activities in managing credit, market, liquidity, operational, regulatory, legal and other significant risks or exposures and the steps Management has taken to monitor and control such risks to CSBI. Senior management shall provide the Committee with periodic information on the risk exposures and risk management activities.

2. Review and approve the risk management function, including its role, scope, activities, staffing, budget and organizational structure and concurrence with Management in the appointment, replacement, compensation and dismissal of the Risk Officer officer appointed by Management.

3. Review the effectiveness of the risk management function, assess the adequacy of its function in terms of its resources, the scope of its work and its reporting arrangements.

4. On a regular basis, meet separately with the Management to discuss matter relevant to managing and controlling the risk exposure of CSBI.

5. The responsibilities related to risk management shall be transferred to the Risk Management Committee.

D. Internal Audit

1. Review and approve the internal audit function, including (i) the internal audit charter, (ii) annual plan, activities, staffing, budget and organizational structure of the internal audit function; and (iii) concurrence with Management in the appointment, replacement, compensation or dismissal of the Head of IAD.

2. Evaluate the audit scope or any required change thereof and role of internal audit.

3. Review the effectiveness of the internal audit function, assess the adequacy of the internal audit function in terms of its resources, the scope of its work, its liaison with external audit and other bodies, and its reporting arrangements.

4. Review and discuss with management and the internal auditors the results of the audit, including any difficulties encountered.

5. Ascertain that management responds to recommendations by the internal auditors and is taking appropriate corrective actions in a timely manner.

6. On a regular basis, meet separately with the Head of IAD or Management to discuss any matter relevant to internal controls.

E. External Audit

1. Recommend to the Board the selection or replacement of the external auditor to be proposed for shareholder approval at CSBI's annual shareholders meeting, including all audit engagement fees and terms of the external auditor and review its independence and performance.

2. Review the external auditor's proposed audit plan, scope and approach, including any changes thereof and ensure coordination of audit effort where more than one audit firm is involved.

3. Review and discuss with management and the external auditors the results of the audit, including any difficulties encountered. This review will include any restriction on the scope of the independent auditor's activities or access to requested information and any significant disagreements with management.

4. Ascertain that management responds to recommendations by the external auditors and is taking appropriate corrective actions in a timely manner.

5. Ensure the rotation of the external auditor or of its handling partner every five (5) years or earlier.

6. Evaluate and determine any non-audit service provided to CSBI by the external auditor who is handling the financial audit of CSBI and keep under review the non-audit fees paid to the external auditor both in relation to their significance to the auditor and in relation to CSBI's total expenditure on consultancy. The non-audit work should be disclosed in the annual report. Actively engage in a dialogue with the external auditors with respect to any disclosed relationships or services that may impact their objectivity and independence and if appropriate, recommend that the Board take appropriate action to ensure their independence.

7. On a regular basis, meet separately with the external auditors or Management to discuss any matter relevant to the audit of the Bank's financial reports.

F. Compliance with Laws and Regulations

1. Review the effectiveness of the system for coordinating, monitoring and facilitating compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary actions) of any instances of non-compliance.

2. Review and approve the compliance function, including its role scope, activities, staffing budget, and organizational structure and concurrence with Management in the appointment, replacement, compensation or dismissal of the Compliance officer.

3. Review the effectiveness of the compliance function, assess the adequacy of its function in terms of its resources, the scope of its work, its liaison with regulatory bodies and its reporting arrangements.

4. Review the findings of any examinations by regulatory agencies, compliance

officer and internal/external auditors.

5. Assess whether all regulatory compliance matters have been considered in the preparation of the financial statements.

6. Obtain regular updates from Management, compliance officer and CSBI's legal counsel regarding compliance matters.

7. When deemed appropriate, review with CSBI's general counsel any legal, tax, regulatory, disclosure or other matters that may have a material impact on CSBI's operations and its financial statements.

8. On a regular basis, meet separately with the Compliance Officer or Management to discuss any matters that the Committee of the Compliance Officer believes is relevant to compliance with the laws and regulations.

G. Ethics and Business Conduct

1. Ascertain that a code of conduct exists in writing and that arrangements are made for all employees to be aware of it.

2. Review the Bank's code of conduct annually and ensure that a system reasonably designed to assure compliance with the code is in place.

H. Reporting Responsibilities

1. Report to the Board about the Committee activities, issues, actions and related recommendations, as the committee may deem appropriate.

2. Ensure that the Board is aware of matters, which may significantly impact the financial condition of business affairs of the Bank.

3. Review any other reports issued by CSBI that relate to Committee responsibilities.

I. Other Responsibilities

1. Record its recommendation to the Board in written form that will be incorporated as a part of the minutes of the Board of Directors, to the extent deemed appropriate.

2. Perform such other functions as assigned by law, CSBI's Charter or By Laws or the Board.

3. Direct management to conduct special investigations as needed.

4. Review policies and procedures with respect to transactions between CSBI and its officers and directors or affiliates of officers or directors, or transactions that are not a normal part of CSBI's business.

5. Review and assess the adequacy of this Charter annually, requesting Board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.

6. Self-assess annually that all responsibilities outlined in this Charter have been carried out.

VI. – SUCCESSION PLAN FOR CHAIRMAN AND MEMBERS

Resigned member of the Audit Committee shall be replaced by a qualified member of the board of directors. The board shall appoint an independent director is case the vacancy is the chairmanship position.

VI. PROCEDURES

The Chairman of the Committee shall establish such rules as may from time to time be necessary and proper for the conduct and business of the Committee.

APPROVED: BOARD OF DIRECTORS

DATE : ______________________________

ANNEX H

RISK MANAGEMENT MANUAL

IMPORTANT NOTE

A hard copy of this document must always be available at the Department's premises.

FOREWORD

Citystate Savings Bank, Inc. (CSBI) is committed to the preservation of its reputation and integrity through compliance with applicable laws, regulations and ethical standards in the banking community in which it operates. All CSBI Management Officers and Staff are expected to adhere to these laws, regulations and ethical standards, and the Senior Management is responsible for ensuring such compliance. Compliance is therefore an essential ingredient of good corporate governance.

The Board of Directors has collective responsibility for managing risk across its banking business operations. The Senior Management officers had the direct responsibility for managing risk within its respective business unit. Dedicated Risk Officers and staff assist the unit heads in risk management.

PART I

RISK OVERSIGHT COMMITTEE

Charter

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
23 Dec '08	Initial Copy	1.0	Reviewed and approved by the Board of Directors under Resolution No. 2008 – 0046
10 Dec '13	Updated	2.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

Please edit this page whenever changes are made to this document in order to maintain version control.
This document needs to be updated regularly in order to ensure that the policies and procedure guidelines are current.

PART II

RISK MANAGEMENT DEPARTMENT

Mandate

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
10 Dec '13	Initial Copy	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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This document needs to be updated regularly in order to ensure that the policies and procedure guidelines are current.

PART III

RISK MANAGEMENT

Framework

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
10 Dec '13	Initial Copy	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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PART IV

STRATEGIC RISK MANAGEMENT

Guidelines

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
10 Dec '13	Initial Copy	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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PART V

CREDIT RISK MANAGEMENT

Guidelines

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
07 Mar '11	Initial Copy	1.0	Presented to Senior Management for review and was "Conditionally Approved" for BSP review purposes
30 May '13	Updated	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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PART VI

LIQUIDITY RISK MANAGEMENT

Guidelines

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
07 Mar '11	Initial Copy	1.0	Presented to Senior Management for review and was "Conditionally Approved" for BSP review purposes
30 May '13	Updated	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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PART VII

MARKET RISK MANAGEMENT

Guidelines

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
07 Mar '11	Initial Copy	1.0	Presented to Senior Management for review and was "Conditionally Approved" for BSP review purposes
30 May '13	Updated	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

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PART VIII

OPERATION RISK MANAGEMENT

Guidelines

TABLE OF CONTENTS

VERSION CONTROL

Date	Description	Current Version	Status/Remarks
30 May '13	Updated	1.0	Presented to Senior Management for review and endorsement to the Board of Directors for approval

Please edit this page whenever changes are made to this document in order to maintain version control.
This document needs to be updated regularly in order to ensure that the policies and procedure guidelines are current.

Section 1 PURPOSE

The Risk Oversight Committee (the "ROC" or "Committee") of Citystate Savings Bank, Inc. (the "CSBI" or "Bank") is a standing committee of the Board of Directors ("Board").

The purpose of the Committee is to assist the Board in fulfilling its responsibility with respect to:

1.1 the Citystate Savings Bank, Inc. (CSBI)'s risk governance structure,

1.2 the Bank's risk management guidelines and policies regarding credit, liquidity, market, operational and other related risk as necessary to fulfil the Committee's duties and responsibilities,

1.2 the Bank's risk tolerance

1.3 the Bank's capital, liquidity and funding, and

1.4 the performance of Bank's Chief Risk Officer

The Committee reports to the Board of Directors regarding Bank's risk profile, as well as its risk management framework, including the significant policies and practices employed to manage risks in CSBI's businesses, as well as the overall adequacy of the risk management function.

The Committee's role is one of oversight, recognizing that Senior Management is responsible for executing the bank's risk management. While the Committee has the responsibilities and powers set forth in this Charter, Senior Management is responsible for designing, implementing and maintaining an effective risk program. In this regard, the Bank's department heads or line managers are responsible for managing risks in the areas for which they are responsible.

Finally, the Bank's Chief Risk Officer ("CRO") manages the Bank's risk management guidelines and policies regarding credit, liquidity, market, operational and other related risk on a consolidated basis under CSBI's risk management framework.

The CRO also provide overall leadership for CSBI's risk management framework, independent risk management function and risk governance processes, including risk identification, measurement, monitoring and mitigation (i.e., I'M^3 Risk Framework)

Section 2 MEMBERSHIP

2.1 The Committee shall be represented by at least three (3) Board members appointed by the Board of Directors after considering the recommendation of the Nominating and Governance Committee or until their successors shall be duly qualified and appointed.

2.2 One of the Board members in the Committee should be an independent director who has no material relationship to the Bank – or its subsidiaries or affiliates – that may interfere with the exercise of his/her independence from management and the Bank or shall otherwise compromise the independence requirements of the regulatory authorities.

2.3 The Board shall designate one Committee member as the Committee's chair (the "Chairman").

2.4 The Board may also appoint any Senior Management Officers as *ex officio* or non-voting member of the Committee.

Section 3 OPERATIONS

3.1 The Committee shall hold regular meetings at least four times per year and report to the Board on a regular basis.

3.2 Meetings shall include any participants the Committee deems appropriate and shall be of sufficient duration and scheduled at such times as the Committee deems appropriate to discharge properly its responsibilities.

3.3 The Committee shall meet, as deemed necessary and appropriate, with the Chief Risk Officer and other Senior Management officers of the Bank, in separate executive sessions.

3.4 The Committee may form and delegate to one or more subcommittees all or any portion of the Committee's authority, duties and responsibilities, and may establish such rules as it determines necessary or appropriate to conduct the Committee's business.

3.5 The Committee shall have direct access to, and complete and open communication with, the Bank's Senior Management, including the Chief Risk Officer and other employees of the Risk Department, and may obtain advice and assistance from internal legal or other advisors.

3.6 The Bank shall provide for appropriate funding, as determined by the Committee, for the payment of:

a. ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties and responsibilities, and

b. compensation to independent legal or other advisors retained by the Committee.

3.7 The Committee shall review and assess annually its performance and report the results to the Board.

3.8 The Committee shall review and assess annually the adequacy of this charter and, if appropriate, recommend changes to this charter to the Board of Directors for approval.

Section 4 OVERSIGHT FUNCTIONS

Oversight of Risk Management

4.1 Review or discuss, as and when appropriate, with Senior Management, the Bank's risk governance structure and the Bank's risk management, guidelines and policies regarding credit, liquidity, market, operational and other related risk and the Bank's risk tolerance.

4.2 Review periodically the major risk exposures of the Bank and its business units, including credit, liquidity, market, operational and other related risk, against established risk measurement methodologies and the steps management has taken to monitor and control such exposures.

4.3 Receive, as and when appropriate, reports and recommendations from the Head of the Internal Audit Department (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) regarding the results of risk management reviews and assessments.

Oversight of Risk Tolerance

4.4 Oversee the Bank's process and policies for determining risk tolerance and review management's measurement of overall risk tolerance to established levels. As appropriate, confirm risk tolerance levels and capital targets and limits.

4.5 Receive, as and when appropriate, reports and recommendations from the Senior Management (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) on risk tolerance.

Oversight of Capital, Liquidity and Funding

4.6 Review periodically the steps the Bank management has taken to manage capital, liquidity and funding.

4.7 Receive, as and when appropriate, reports and recommendations from the Head of the Treasury Department (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) on capital, liquidity and funding risk guidelines and policies.

Oversight of the Chief Risk Officer

4.8 Approve the appointment and, when and if appropriate, replacement of the Chief Risk Officer, who shall report directly to the Committee as well as to the Chief Executive Officer.

4.9 Review and evaluate periodically the qualifications and performance of the Chief Risk Officer.

Coordination with Other Board Committees and Senior Management

4.10 Coordinate with the Audit Committee and Operations Committee to help ensure that the Committee have received the information necessary to permit them to fulfil their duties and responsibilities with respect to oversight of risk management and risk assessment guidelines and policies.

4.11 Coordinate with the Compensation and/or Personnel Committee in relation to that Committee's role with respect to risk matters related to compensation.

Other Functions

4.12 Make such recommendations with respect to any of the above and other matters as the Committee deems necessary or appropriate.

4.13 Have such other authority, duties and responsibilities as may be delegated to the Committee by the Board.

Section 5 CORE RESPONSIBILITIES

(Per BSP Circular No. 749, Series of 2012 – "Guidelines in Strengthening Corporate Governance in BSP supervised FIs"

5.1 *Identify and evaluate exposures*

The Committee shall assess the probability of each risk becoming reality and shall estimate its possible effect and cost. Priority areas of concern are those risks that are most likely to occur and are costly when they happen.

5.2 *Develop risk management strategies*

The Committee shall develop a written plan defining the strategies for managing and controlling major risks. It shall identify practical strategies to reduce the chance of harm and failure or minimize losses if the risk becomes real.

5.3 *Oversee the implementation of the risk management plan*

The Committee shall conduct regular discussion on the institution's current risk exposure based on regular management reports and assess how the concerned units or offices reduced these risks.

5.4 *Review and revise the plan as needed*

The Committee shall evaluate the risk management plan to ensure its continued relevance, comprehensiveness, and effectiveness.

It shall revisit strategies, look for emerging or changing exposures, and stay abreast of developments that affect the likelihood of harm or loss.

The Committee shall report regularly to the Board of Directors the Bank's overall risk exposure, actions taken to reduce the risks, and recommend further actions or plans as necessary.

Section 1 RISK MANAGEMENT FUNCTION

Overall risk management function provides an oversight of the management of risks inherent in the institution's activities.

Per BSP Circular No. 749, Series of 2012 – "Guidelines in Strengthening Corporate Governance in BSP supervised FIs" – the risk management function is generally responsible for:

1.1 Identifying the key risk exposures and assessing and measuring the extent of risk exposures of the bank and its trust operations;

1.2 Monitoring the risk exposures and determining the corresponding capital requirement in accordance with the Basel capital adequacy framework and based on the bank's internal capital adequacy assessment on an on-going basis;

1.3 Monitoring and assessing decisions to accept particular risks whether these are consistent with board approved policies on risk tolerance and the effectiveness of the corresponding risk mitigation measures; and,

1.4 reporting on a regular basis to the Board of Directors of the results of risk assessment and monitoring.

Section 2 RISK MANAGEMENT DEPARTMENT

Banking institutions should institute a setup that supervises overall risk management at the bank. Such a setup could be in form of a risk management unit or department depending on the size and complexity of the banking institution.

Ideally, overall risk management function should be independent from those who take or accept risk on behalf of the institution.

General Responsibilities

The Risk Management Department (RMD) is primarily responsible for identifying, measuring, assisting in controlling [mitigating] and monitoring risk inherent in the bank's activities. It shall primarily assist the Risk Oversight Committee by:

2.1 Providing a systematic, disciplined and effective approach to assess inherent general and functional risks to ensure the financial and operational soundness of the Bank and its ongoing operations;

2.2 Assist the bank to accomplish its business objectives by improving the effectiveness of risk management, control and governance processes;

2.3 Periodically reviews the adequacy and effectiveness of the systems of internal control to ensure that the said systems minimize risk and identify exposure while the consequences are still avoidable; and,

2.4 Implement an enterprise-wide risk management process within the bank by promoting compliance with managerial policies, regulations and sound fiduciary principles;

As matter of principle, where individuals responsible for overall risk management function are involved in day to day operations, then sufficient checks and balances should be established to ensure that risk management is not compromised.

Specific Duties

As a business function, RMD shall undertake the following:

2.5 Review periodically and recommend risk management framework, including the development of effective policies and efficient procedures to implement such framework.

2.6 Recommend to the Risk Oversight Committee policies and procedure guidelines for risk identification, measurement, mitigation and monitoring.

2.7 Provide the Risk Oversight Committee relevant and timely reporting of risks exposure by the bank that will assist them in the effective discharge of their responsibilities.

2.8 Review and recommend to the Board of Directors the system of allocating capital to the bank and incorporating it in the budget-planning processes.

2.9 Evaluate the magnitude, direction and distribution of risks across the bank and its subsidiaries and/or affiliates from a portfolio perspective.

2.10 Assess the risk infrastructure if it satisfies governance policies and is consistent with the regulatory and technology developments..

2.11 Promote the continuous development of risks programs and infrastructure, understanding this to be an evolutionary and dynamic process.

2.12 Ensure ongoing review and validation of the adequacy and soundness of risk management policies, assumptions and practices.

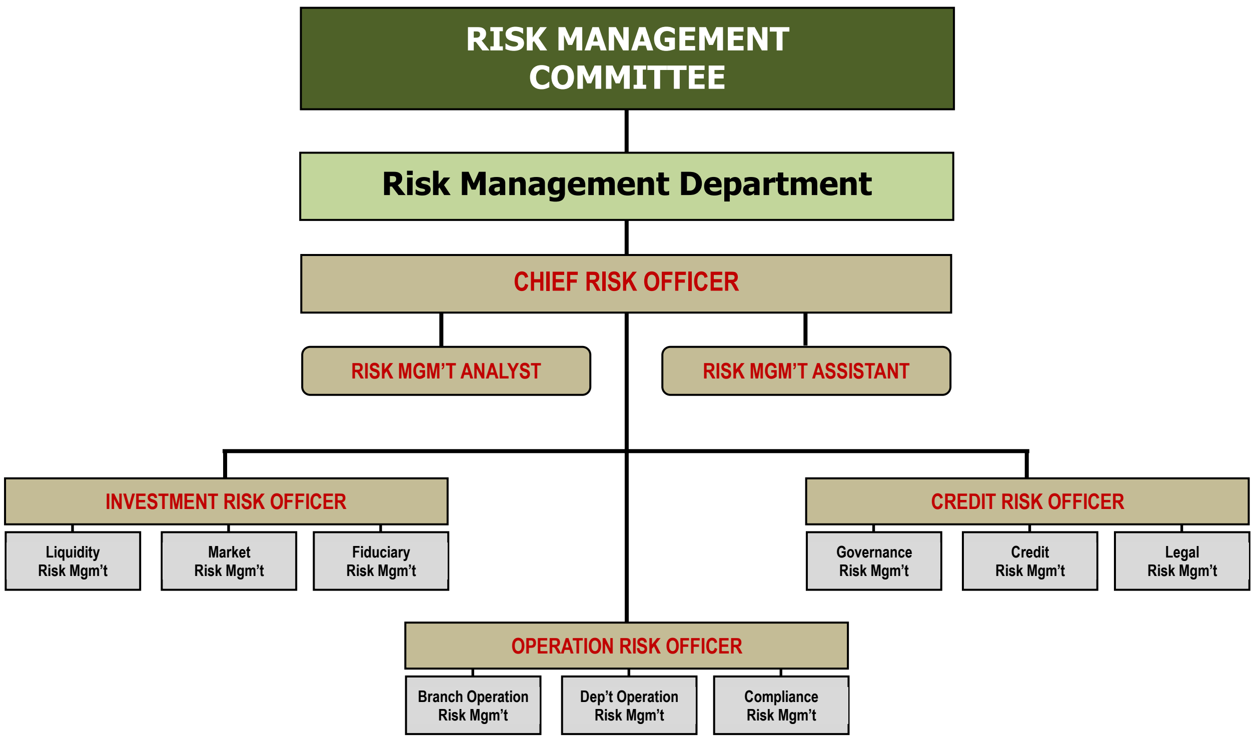
2.13 Create and promote a risk abatement culture that requires and encourages the highest standards of ethical behaviour by Directors, Officers and Staff of CSBI.

2.14 Encourage the professional development and training of staff engaged in risk management (risk-taking and risk control).

However, it must not be construed that risk management is only restricted to individual(s) responsible for overall risk management function. Business lines are equally responsible for the risks they are taking. Because line personnel, more than anyone else, understand the risks of their activities, any absence or lack of accountability on their part can run counter to sound and effective risk management.

Section 3 TABLE OF ORGANIZATION

Per BSP Circular No. 749, Series of 2012 – "Guidelines in Strengthening Corporate Governance in BSP supervised FIs" –risk management personnel shall possess sufficient experience and qualifications, including knowledge on the banking business, the developments in the market, industry and product lines, as well as mastery of risk disciplines. They shall have the ability and willingness to challenge business lines regarding all aspects of risk arising from bank's activities.



Section 4 CHIEF RISK OFFICER

A Chief Risk Officer (CRO) shall be appointed or replaced with prior approval from the Board of Directors. The Board shall also ensure the independence of the CRO by providing direct access to the Board and Risk Oversight Committee without any impediment.

The CRO shall be independent from executive functions, business line responsibilities, operations and revenue-generating functions. The CRO may report administratively to the President but the Board shall confirm the performance rating given by the President.

The CRO shall have sufficient stature, authority and seniority within the bank to have unrestricted access to key corporate information as he/she deems necessary to form his/her judgement.

The CRO heads the day-to-day management of the Risk Management Department, which is primarily responsible to develop and execute risk management policies and procedures. The role of the Chief Risk Officer includes the following:

4.1 Assist the Risk Oversight Committee (RMC), Board of Directors and Senior Management to establish and communicate the Bank's risk management objectives and direction.

4.2 Assist the ROC/BOD and Senior Management to develop and communicate risk management policies.

4.3 Facilitate in the identification, measurement, monitoring, reporting and control of credit risks, market and liquidity risks, operational risks and all other related risk.

4.4 Monitor and assess decisions to accept particular risks whether these are consistent with board approved policies on risk tolerance and the effectiveness of the corresponding risk mitigation measures.

Section 5 RISK OFFICERS

Risk Management Department is primarily tasked to identify, measure and assist in controlling [mitigating] and monitoring the risks inherent to the bank's activities. As such, the RMD distinguishes (3) three four specific risk officers: (i) credit risk officer; (ii) operations risk officer; and, (iii) investment risk officer.

5.1 Investment Risk Officer (IRO)

NOTE: Investment risks cover proprietary (i.e., on-bank) investments which falls under the responsibility of bank's Treasury Department and fiduciary (i.e., off-bank) investments undertaken by the banks Trust Department. The Investment Risk Officer shall assume "both" proprietary (i.e., liquidity and market risks) and fiduciary investment risks shall be called Investment Risk Officer.

Liquidity risk is the risk arising from Bank's potential inability to meet all payment obligations when they become due, or only being able to meet these obligations at excessive costs.

The bank's Treasury Department is responsible for the management of liquidity risk. The Bank's liquidity risk management framework is designed to identify, measure and manage the liquidity risk position. The underlying policies are reviewed and approved by the Asset and Liability Committee (ALCO).

The bank's liquidity policy is to manage its operations to ensure that funds available are more than adequate to meet credit demands of its customers and to enable deposits to be repaid on demand or upon maturity. The main sources of the Bank's funding are capital, core deposits from retail and commercial clients and wholesale deposits. The bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position.

To ensure that the bank has sufficient liquidity at all times, the bank's Treasury formulates a contingency plan using extreme scenarios of adverse liquidity and evaluates the Bank's ability to withstand these prolonged scenarios. The contingency plan focuses on the bank's strategy for coordinating managerial action during a crisis and includes procedures for making up cash flow shortfalls in adverse situations. The plan details the amounts of funds available and the scenarios under which it could use them.

Market risk, on the other hand, arises from the uncertainty concerning changes in market prices and rates. These include interest rates, equity prices, foreign exchange rates and commodity prices, among others. Market risk is present in both trading and non-trading activities. The bank assumes market risk by taking proprietary positions in debt, equity, foreign exchange and other securities. As a matter of rule, the Bank will not recommend investment outlets for fiduciary clients that that Bank itself is not willing to take proprietary positions, except on directional accounts.

The bank uses risk sensitivities, value-at-risk, mark-to-market and stress testing metrics to manage market risks and establish limits. Value-at-risk is the primary measure used in managing market risk in the trading book.

Market risk in non-trading activities consists mainly of interest rate risk in the banking book, as well as other assets not subject to mark-to-market.

Duties and Responsibilities

a. Responsible for the adequate identification, measurement, oversight of market, liquidity and fiduciary risk exposures and monitor compliance with the defined limits and their continuous control;

b. Maintenance and improvement of methods, models and tools to identify and measure risk limits for all investment/trading activities using quantitative measures for market (e.g. VaR), liquidity (e.g. Liquidty Gap Report) and fiduciary investment (e.g., Portfolio EaR);

c. Develop, implement, review and enhance the Bank's investment risk management framework to achieve a synergetic risk management environment.

d. Conduct scenario analysis and stress testing of market, liquidity and fiduciary risk in the ordinary course of business and in crises conditions;

e. Preparation and regular update of relevant risk management policies and procedures in line with regulatory, management and internal requirements;

f. Provide product support function in the evaluation and introduction of new bank products.

g. Implementation and assurance of compliance to Basel regulations; and,

h. Assume all other risk functions and responsibilities assigned by the CRO.

5.2 Credit Risk Officer (CrRO)

Credit risk arises from all transactions that give rise to actual, contingent or potential claims against any counterparty, borrower or obligor.

This is the risk that the borrower, issuer or counterparty in a transaction may default and cause a potential loss to the Bank.

The Bank is exposed to credit risk as trading counterparty to dealers and customers, as direct lender and as a holder of securities.

Categories of credit risk include contingent credit risk (risk that potential counterparty or customer obligations become actual and will not be repaid on time), country risk (risk that actions of sovereign governments or other uncontrollable events will adversely affect the ability of counterparties or customers to fulfill obligations to the Bank), event risk (risk that the bank will incur risk in unusual situations which are not captured in the daily risk management tools), underwriting risk (risk that an issue will lose value after launching but before trading in the secondary markets), and custody risk (risk that arises when the Bank has assets in the form of securities entrusted to a third party as a custodian).

Credit risk management partners with business segments in identifying and aggregating credit risk exposure across all business lines.

The credit policy framework establishes credit approval authorities, industry concentration limits, risk rating methodologies and portfolio review parameters.

Wholesale credit is monitored both on an aggregate portfolio as well as individual name basis. The bank diversifies exposure by borrower and industry concentration.

Monitoring of the portfolio consists of regular reports of aggregate credit exposure, limit exceptions, risk rating changes, as well as industry concentration and adequacy of provisions.

Duties and Responsibilities

a. Responsible for the adequate identification, measurement, oversight of credit risk exposures and monitor compliance with the defined limits and their continuous control;

b. Maintenance and improvement of methods, models and tools to identify and measure risk limits for all credit risk exposure across all business lines;

c. Develop, implement, review and enhance the Bank's credit risk management framework to achieve a synergetic risk management environment.

d. Conduct scenario analysis and stress testing of credit exposure and risk concentration and on a portfolio basis in crises conditions;

e. Preparation and regular update of relevant credit risk management policies and procedures in line with regulatory, management and internal requirements;

f. Provide support function in the evaluation of credit and in the loan processing to loan release and monitoring.

g. Implementation and assurance of compliance to Basel regulations; and,

h. Assume all other risk functions and responsibilities assigned by the CRO.

5.3 Operations Risk Officer (ORO)

Operational risk is the risk of loss from failed processes, people, systems or external events. Operational risk management is responsible for defining the operational risk framework and related policies. The responsibility for implementing the framework, as well as day to day operational risk management, lies with the business units.

Techniques used to efficiently manage operational risk consist of control self-assessments, maintaining a loss events database, and the development and monitoring of key operational risk indicators.

In addition, the bank shall ensure that its operating manuals are regularly updated. A Business Contingency Plan as well as Disaster Recovery Plan is in place. The bank shall place emphasis on the security of its information technology system and has a comprehensive legal and personnel policy.

Duties and Responsibilities

a. Responsible for the adequate identification, measurement, oversight of operational and other related risk and monitor compliance with the defined limits and their continuous control;

b. Maintenance and improvement of methods, models and tools to identify and measure risk limits for all operational and and other related risk infrastructure;

c. Conduct New Business Initiatives (NBI) risk reviews, document operational risk incidence and IT process breakdowns, establish Key Risk Indicators (KRIs) and derive root causes for deviations and prepare due dilligence report on Risk and Control Self Assessments (RCSA) across all business units;

d. Preparation and regular update of relevant operational risk management policies and procedures in line with regulatory, management and internal requirements;

e. Oversee the assessment of all key business projects and key business process changes to confirm the impact on the operational risk profile, risk management framework and adequacy of the broader cross functional due diligence processes in respect of legal risks, litigation, regulatory changes, procedure & policy changes, among others.

g. Implementation and assurance of compliance to Basel regulations; and,

h. Assume all other risk functions and responsibilities assigned by the CRO.

Section 6 RISK MANAGEMENT ANALYST (RMA) / RISK ASSISTANT (RA)

The Risk Management Analyst / Risk Assistant will perform the CRO's support function, as well as, initiate and lead initiatives essential for the execution of RMD's business function.

The RMA is expected to incubate various risk management frameworks into strategic policies and procedures. The RMA shall also be proactive in communicating and/or escalating risk management issues with other internal departments as necessary to fulfil the RMD's duties and responsibilities as well as coordinate the work-output of other risk officers. The RA, on the other hand, shall provide administrative support and assistance to complement the RMD.

These positions will then be responsible for performing the following:

6.1 Assistance in the review and recommendation of risk management framework, including the development of effective policies and efficient procedures to implement such framework.

6.2 Consolidation of policies and procedure guidelines for risk identification, measurement, management and monitoring of investment, credit, operations and other related risks.

6.3 Preparation of relevant and timely reporting of risks exposure by the bank that will assist the Senior Management in the effective discharge of their responsibilities.

6.4 Documentation of various recommendations to the Senior Management regarding strategic capital allocation of the bank and incorporating it in the budget-planning processes.

6.5 Assistance in the periodical assessment of bank's risk infrastructure if it satisfies governance policies and documentation of reviews and validations of the adequacy and soundness of risk management policies, assumptions and practices.

6.6 Promotion of the continuous development of risks programs and infrastructure, including the institutionalization of risk abatement culture that requires and encourages the highest standards of ethical behaviour by Directors, Officers and Staff of the bank.

6.6 Assist in the implementation of compliance to Basel regulations; and,

6.7 Assume all other risk functions and responsibilities assigned by the CRO.

Section 1 INTRODUCTION

In the course of conducting banking business, banks and financial institutions (hereinafter referred to as 'institutions') assume risks in order to realize returns on their investments. On the other hand, risks assumed have the potential to wipe out expected returns and may result into losses to the institutions. These losses could be either expected or unexpected. Expected losses are those that an institution knows with reasonable certainty will occur (e.g. the expected default rate of loan portfolio) and are typically reserved for in some manner. Unexpected losses are those associated with unforeseen events (e.g. losses due to a sudden downturn in economy, falling interest rates, natural disasters, or human action such as terrorism). Institutions rely on their capital as a buffer to absorb such losses.

Due to this fact, the need for effective risk management framework in financial institutions (FIs) cannot be over emphasized. Through effective risk management framework, institutions will be able to optimize their risk-return trade off.

Section 2 OBJECTIVES

The Banko Sentral ng Pilipinas (BSP) has legitimate interest in ensuring that its supervised institutions operate in a safe and sound manner. This goal can be largely attained if institutions effectively manage their risks.

To enhance risk management practices among institutions, BSP has issued *"Guidelines on Supervision by Risk"* to provide guidance on how FIs should identify, measure, monitor and mitigate (control) risks. The guidelines set forth the expectations of the BSP with respect to the management of risks and are intended to provide more consistency in how the risk-focused supervision function is applied to these risks. The BSP will review the risks to ensure that an FI's internal risk management processes are integrated and comprehensive. All FIs should follow the guidelines in their risk management efforts.

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

Section 3 RISK DESCRIPTIONS

This prospectus cover the risks in banking described as follows:

3.1 Strategic Risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes.

This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other changes.

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

Other Strategic-related Risks

A key success factor in furthering risk management was the support at the highest levels of banking organizations, including not only various levels of management, but the board as well. In this regard, the following risks shall be addressed by the Committee:

a. Business Risk

Business risk refers to conditions which may be detrimental to a bank's business model and its ability to generate returns from operations, which in turn erodes its franchise value. Combining business risk with the financial risk arising from the use of borrowed funds generates total corporate risk of the bank. Business risks shall include, but not limited to, the following:

i. Risks to reputation that arise from internal decisions that may damage a bank's market standing;

ii. Risks to reputation that arise from internal decisions and practices that ultimately impinge on the public's trust of a bank;

iii. Risks from the actions of a bank that are contrary to existing regulations and identified best practices and reflect weaknesses in the implementation of codes of conduct and standards of good practice;

iv. Legal risks to the extent that changes in the interpretation or provisions of regulations directly affect a bank's business model.

Source: BSP Circular No. 747, Series of 2012
"Revised Compliance Framework for Banks"

b. Reputation Risk

Reputation risk is the current and prospective impact on earnings or capital arising from negative public opinion.

This affects the FI's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the FI to litigation, financial loss, or a decline in its customer base. In extreme cases, FIs that lose their reputation may suffer a run on deposits. Reputation risk exposure is present throughout the organization and requires the responsibility to exercise caution in dealing with customers and the community.

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

3.2 Credit Risk

Credit risk arises from counterparty's failure to meet the terms of any contract with the FI or otherwise perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises any time FI funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet. Credit risk is not limited to the loan portfolio

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Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

To improve bank's credit risk management practices, the BSP has issued a number of regulations:

a. Circular No. 389, which sets out the basic guidelines for the granting of loans and other credit accommodations;

b. Circular No. 414, which sets out the principles for the management of large credit exposures and credit risk concentrations;

c. Circular No. 423, which sets out specific guidelines regarding banka dealing with its Directors, Officers, Stakeholders and Related Interests (DOSRI);

d. Circular No. 425, which sets a limit on single borrower; and,

e. Circular No. 439, which requires banks to put in place internal credit risk rating system for their lending activities.

3.3 Liquidity Risk

Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from an FI's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

In terms of capital markets and trading activities, FIs face two types of liquidity risk: funding liquidity risk and market liquidity risk. Funding liquidity risk refers to inability to meet investment and funding requirements arising from cash flow mismatches without incurring unacceptable losses or costs. This is synonymous with the general definition of liquidity risk.

Market liquidity risk, on the other hand, refers to the risk that an institution cannot easily eliminate or offset a particular position because of inadequate liquidity in the market. The size of the bid/ask spread of instruments in a market provides a general indication of its depth, hence its liquidity, under normal circumstances. Market liquidity is also associated with the probability that large transaction may have a significant effect on market prices that lack sufficient depth. In addition, market liquidity risk is associated with structure or complex investment as the market potential buyers is typically small. Finally, FIs are exposed to the risk of an unexpected erosion of market liquidity. This could be the result of sharp price movement or jump in volatility, or internal to the FI such that posed by a general loss of market confidence.

Source: BSP Circular No. 545, Series of 2006
"Guidelines on Liquidity Risk Management"

3.4 Market Risk

Market risk is the risk to earnings or capital arising from changes in the value of traded portfolios of financial instruments. This risk arises from market-making, dealing, and position-taking in interest rate, foreign exchange, equity and commodities markets. Interest rate risk, on the other hand, is the current and prospective risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among different yield curves affecting FI activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in FI products (options risk).

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

3.5 Operational Risk

Operational risk is the current and prospective risk to earnings or capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information.

Risk is inherent in efforts to gain strategic advantage, and in the failure to keep pace with changes in the financial services marketplace. Operational risk is evident in each product and service offered. Operational risk encompasses: product development and delivery, operational processing, systems development, complexity of products and services, and the internal control environment.

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

Other Operational-related Risks

Operational risk management is an evolving risk discipline. As such, it should cover several areas of internal operations to manage operational risk. These are as follows:

a. Personnel Risk

Personnel risk is generally defined as the potential losses due to inadequacy of human capital management and development. This type of risk is not subject to specific measurement or quantification, but as just as significant and may cause material damages to the bank.

b. <u>Legal Risk</u>

Basel define legal risk as "includ[ing], but … not limited to, exposure to fines, penalties or punitive damages resulting from supervisory actions, as well as private settlements". The BSP, on the other hand, defines legal risk as the probability that a bank may suffer losses as a result of contracts being unenforceable or inadequately documented.

c. <u>Compliance Risk</u>

Compliance risk is defined by Basel as "the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities"

Per BSP, compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain FI products or activities of the FI's clients may be ambiguous or untested. This risk exposes the FI to fines, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential, and lack of contract enforceability.

Source: BSP Circular No. 510, Series of 2006
"Guidelines on Supervision by Risk"

Postscript: Basel defines both legal risk and compliance in the context of operational risk. The current Basel Committee definition of operational risk is "the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events". This definition includes legal risk, but excludes strategic and reputational risk. In common-law jurisdictions, compliance risk is related to adherence to legislation or codified law, while legal risk is related to adherence to the law in a wider sense.

3.6 Information Technology Risk

Information Technology risk is described under Basel as a potential to transform risks from manual processing errors to system failure risks. It also identified the growth of e-commerce as a source of potential risks. It also covers viability issues of new or newly integrated systems and the need for continual maintenance of high-grade internal controls and back-up systems.

The BSP, on the other hand, described Information Technology risk as any potential adverse outcome, damage, loss, violation, failure or disruption associated with the use of or reliance on computer hardware, software, devices, systems, application and networks.

To enhance information technology risk management practices among institutions, BSP has issued the enhanced "Information Technology Risk Management (ITRM)" framework which updates existing IT-related guidelines under Sections X176 and X705 of the Manual of Regulations for Banks (MORB).

Consistent with international standards and best practices, the enhanced ITRM framework is expected to strengthen management of risks, security of operations and governance on IT-related activities, as well as reinforce regulations on consumer protection on electronic products and service by tackling the growing number of new and sophisticated technological threats.

Some of the salient features of the enhanced framework include:

a. adoption of well-structured IT governance model and processes that ensure alignment of IT strategic plan with the institution's business strategy, IT value delivery and effective IT risk management implementation;

b. maintenance of risk identification and assessment process to continuously evaluate IT environment and potential changes; and,

c. establishment of overall IT risk mitigation strategy covering the areas of: (i) information security; (ii) project management, acquisition and change management; (iii) IT operations; (iv) IT outsourcing/vendor management program; and (v) electronic products and services.

Finally, recognizing that no single framework may be considered as "one-size-fits-all," guidelines have been provided to classify FIs as to having "simple" or "complex" IT risk profile. Thus, the level of adopting relevant provisions of the framework may be made proportionate to their IT risk profile.

Source: BSP Circular No. 808, Series of 2013
"Guidelines on Information Technology Risk Management for All Banks and Other BSP Supervised Institutions"

Section 4 RISK MANAGEMENT GUIDELINES

Institutions may have different risk management systems depending on their sizes and complexity. Due to this, the BSP requires each institution to prepare a comprehensive Risk Management Guidelines (RMG) tailored to its needs and circumstances under which it operates. The RMGs should be reviewed at least annually.

It is expected that RMGs prepared by institutions should cover the risks described in these prospectus.

Section 5 RISK MANAGEMENT PROCESS

Risk Management is a discipline at the core of every institution and encompasses all the activities that affect its risk profile.

Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk-reward trade-off. This can be achieved through putting in place an effective risk management framework which can adequately capture and manage all risks an institution is exposed to. Risk Management entails four key processes:

5.1 Risk Identification

In order to manage risks, an institution must identify existing risks or risks that may arise from both existing and new business initiatives for example, risks inherent in lending activity include credit, liquidity, interest rate and operational risks. Risk identification should be a continuing process, and should occur at both the transaction and portfolio level.

5.2 Risk Measurement

Once risks have been identified, they should be measured in order to determine their impact on the institution's profitability and capital. This can be done using various techniques ranging from simple to sophisticated models.

Accurate and timely measurement of risk is essential to effective risk management systems. An institution that does not have a risk measurement system has limited ability to control or monitor risk levels. An institution should periodically test to make sure that the measurement tools it uses are accurate. Good risk measurement systems assess the risks of both individual transactions and portfolios.

5.3 Risk Mitigation

After measuring risk, an institution should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. Institutions may also apply various mitigating tools in minimizing exposure to various risks. Institutions should have a process to authorize exceptions or changes to risk limits when warranted.

5.4 Risk Monitoring

Institutions should put in place an effective management information system (MIS) to monitor risk levels and facilitate timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed.

Section 6 RISK MANAGEMENT FRAMEWORK

A risk management framework encompasses the scope of risks to be managed, the process/systems and procedures to manage those risks and the roles and responsibilities of individuals involved in risk management. The framework should be comprehensive enough to capture all risks an institution is exposed to and have flexibility to accommodate any change in business activities.

Key elements of an effective risk management framework are:

1. active board and senior management oversight;
2. adequate policies, procedures and limits;
3. adequate risk measurement, monitoring and management information systems; and
4. comprehensive internal controls.

6.1 Active Board and Senior Management Oversight

The Board of Directors has the 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 managing and taking risks, and should also ensure that senior management is fully capable of managing the activities that their institutions conduct. While all boards of directors 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 mitigate these risks, the level of technical knowledge required of directors may vary depending on the particular circumstances at the institution.

Directors should 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 addition, directors should take steps to develop an appropriate understanding of the risks their institutions face, possibly through briefings from auditors and experts external to the institution. Using this knowledge and information, directors should provide clear guidance regarding the level of exposures acceptable to their institutions and have the responsibility to ensure that senior management implements the procedures and controls necessary to comply with adopted policies.

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 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 of an institution to have a thorough understanding of banking and financial market activities and detailed knowledge of the activities their institution conducts, including the nature of internal controls necessary to limit the related risks.

6.2 Adequate Policies, Procedures and Limits

An institution's directors 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 institutions should have policies and procedures that address their significant activities and risks, management is expected to ensure that they are modified when necessary to respond to significant changes in the institution's activities or business conditions.

To ensure that, an institution's policies, procedures, and limits are adequate, the same should at minimum address the following:

1. policies, procedures, and limits should provide for adequate identification, measurement, monitoring, and mitigation of the risks posed by its significant activities;

2. policies, procedures, and limits should be consistent with complexity and size of the business, the institution's stated goals and objectives, and the overall financial strength of the institution;

3. policies should clearly delineate accountability and lines of authority across the institution's activities; and,

4. policies should provide for the review of activities new to the institution to ensure that the infrastructures necessary to identify, monitor, and control risks associated with an activity are in place before the activity is initiated.

6.3 Adequate Risk Measurement, Monitoring and Management Information System

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 directors with timely reports on the financial condition, operating performance, and risk exposure of the 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.

Institutions should have risk monitoring and management information systems in place that provide directors and senior management with a clear understanding of the institution's positions and risk exposures.

In order to ensure effective measurement and monitoring of risk and management information systems, the following should be observed: the institution's risk monitoring practices and reports address all of its material risks;

1. key assumptions, data sources, and procedures used in measuring and monitoring risk are appropriate and adequately documented and tested for reliability on an ongoing basis;

2. reports and other forms of communication are consistent with the institution's activities, structured to monitor exposures and compliance with established limits, goals, or objectives and, as appropriate, compare actual versus expected performance; and,

3. reports to management or to the institution's directors 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.

6.4 Adequate Internal Controls

An institution's internal control structure is critical to its safe and sound functioning generally and to its risk management system, in particular.

Establishing and maintaining an effective system of controls, including the enforcement of official lines of authority and the appropriate separation of duties such as trading, custodial, and back-office is one of management's more important responsibilities.

Indeed, 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, safeguards assets, and helps to ensure compliance with relevant laws, regulations, and institutional policies.

Internal controls should be tested by an independent internal auditor who reports directly either to the institution's Board of Directors or its Audit Committee.

Given the importance of appropriate internal controls, the results of audits or reviews, whether conducted by an internal auditor or by other personnel, should be adequately documented, as should management's responses to them.

In order to ensure the adequacy of an institution's internal controls and audit procedures, the following should be observed:

1. the system of internal controls is appropriate to the type and level of risks posed by the nature and scope of the institution's activities;

2. the institution's organizational structure establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits;

3. reporting lines provide sufficient independence of the control areas from the business lines and adequate separation of duties throughout the institution such as those relating to trading, custodial, and back-office activities;

4. official institutional structures reflect actual operating practices;

5. financial, operational, and regulatory reports are reliable, accurate, and timely; wherever applicable, exceptions are noted and promptly investigated;

6. adequate procedures exist for ensuring compliance with applicable laws and regulations;

7. internal audit or other control review practices provide for independence and objectivity;

8. 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 high level attention; and management's actions to address material weaknesses are objectively verified and reviewed; and,

9. the institution's Audit Committee or Board of Directors reviews the effectiveness of internal audits and other control review activities on a regular basis.

Section 7 INTEGRATION OF RISK MANAGEMENT

Risks must not be viewed and assessed in isolation, not only because a single transaction might have a number of risks but also one type of risk can trigger other risks.

Since interaction of various risks could result in diminution or increase in risk, the risk management process should recognize and reflect risk interactions in all business activities as appropriate. While assessing and managing risk the management should have an overall view of risks the institution is exposed to. This requires having a structure in place to look at risk interrelationships across the institution.

Section 8 CONTINGENCY PLANNING

Institutions should have a mechanism to identify stress situations ahead of time and plans to deal with such unusual situations in a timely and effective manner.

Stress situations to which this principle applies include risks of all types. For instance contingency planning activities include disaster recovery planning, public relations damage control, litigation strategy, responding to regulatory criticism, liquidity crisis, etc.

Contingency plans should be reviewed regularly to ensure they encompass reasonably probable events that could impact the institution. Plans should be tested as to the appropriateness of responses, escalation and communication channels and the impact on other parts of the institution.

Section 1 INTRODUCTION

Strategic risk arises from an institution's inability to implement appropriate business plans, strategies, decision making, resource allocation and its inability to adapt to changes in its business environment. This risk is therefore a function of:

1. a banking institution's strategic goals;
2. the business strategies developed to achieve the goals;
3. the resources deployed in pursuit of these goals, and the quality of implementation; and
4. the resources needed to carry out business strategies both tangible and intangible.

They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. In strategic management, the organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

1.1 Common Sources of Strategic Risk

Strategic risk can arise through many ways. However, the common sources of the risk within banking institutions are the following:

a) competition – through emerging industry rivals;
b) technology – shift in technology;
c) customer - customer priority shift and over-reliance on a few customers;
d) economic factors;
e) regulations;
f) work processes and procedures; and
g) adequacy of information for decision-making.

1.2 Strategic Planning Process

Every institution should put in place a strategic plan which should be supported by a realistic budget. A strategic plan clarifies an institution's overall purpose, defines goals and priorities and determines practical approaches for achieving targeted priorities.

If the strategic planning process is not appropriate or if the assumptions are not realistic, the strategic plan will be flawed thereby exposing the banking institution to strategic risk.
In this regard, every institution should have an appropriate strategic planning process encompassing the following:

a. support or participation of the board, delegated committees, and senior management;

b. participation of staff from various departments;

c. adequacy of information in developing assumptions in relation to economic factors, position of the banking institution compared to competitors, current competitive position, future market trends and customer needs, among others;

d. consistency of the operational plans with the overall objective of a banking institution, and

e. assessment of actual performance against strategic plans.

1.3 Risk Mitigation Factors

Banking institutions should adopt and implement robust strategic risk mitigation measures and techniques to enhance the achievement of strategic objectives. These include engaging qualified members of the Board of Directors and Senior

Management, formulation of strategic and operational plans, high quality of personnel and proper training, comprehensive risk management systems and adequate access to information.

Section 2 BOARD AND SENIOR MANAGEMENT OVERSIGHT

Board of Directors and Senior Management oversight is an integral part of an effective strategic risk management program. The Board of Directors retains the overall responsibility for strategic risk management of the institution. It is chiefly responsible for setting corporate strategy and reviewing management performance in implementing the banking institution's strategic plan.

In turn, Senior Management have a duty to ensure that there is an effective strategic risk management process by transforming the strategic direction given by the Board through policy. To do this, Senior Management should have an understanding of the nature and level of the various risks associated with the banking institution's strategic plan and how such risks fit within the overall business strategies.

2.1 Board Oversight

The responsibilities of the Board of Directors with regard to strategic risk management are to:

a. ensure that risk management practices are an intrinsic part of strategic planning;

b. establish corporate objectives and values, strategic goals, and a mission statement describing the purpose of the banking institution; and ensure that these are effectively communicated and consistently applied throughout the banking institution;

c. ensure that the banking institution's overall strategic risk exposure is maintained at prudent levels, and is compatible with business strategies;

d. assess whether the institution's strategic/business plans make sense given the current economic and competitive environment, consist of reasonable and measurable targets, and; review the associated Strategic Risk Management framework periodically to determine that it remains adequate and appropriate under the prevailing business environment;

e. assess management's success in implementing the banking institution's strategic plan and achieving targets and results;

f. ensure that strategic direction and initiatives are well conceived and supported by appropriate management information system, operating systems, and service delivery networks; the Board must also ensure that initiatives are supported by capital for the foreseeable future and pose only nominal possible effects on earnings volatility; and

g. ascertain that strategic initiatives are supported by sound due diligence and strong risk management systems; also ascertain that decisions can be reversed with little difficulty and manageable costs.

2.2 Senior Management Oversight

The responsibilities of the Senior Management with regard to strategic risk management are to:

a. ensure that a comprehensive Strategic Risk Management process that is commensurate with the strategic goals of the bank is in place;

b. ensure that business continuity plans have been prepared and tested so that important changes in the business/risk environment are assessed and catered for;

c. ensure that management of succession planning is an active ongoing process, integrated with the institution's strategic plans; and

d. ensure that Strategic Risk Management framework is implemented throughout the institution and that all levels of staff understand their responsibilities with respect to Strategic Risk Management.

Section 3 POLICIES, PROCEDURES & LIMITS

Effective management of strategic risk requires that the banking institution establishes prudent policies, procedures and limits approved by the Board to ensure its objective evaluation and responsiveness to the banking institution's business environment.

Policies on business strategy are critical in defining the business segments that the institution will focus on, both in the short and long run.

Policies and procedures should cover all material risks associated with the banking institution's business segments defined in the strategic plan. Accountability should be spelt out clearly and lines of authority for all the banking institution's business segments should be clearly defined.

To be effective, policies and procedures should be reviewed on regular basis, to take into account internal and external changes to the operating environment. The policies should establish clear guidelines on frequency and procedures for review of its business strategies. Policies should be consistent with the organisation's broader business strategies, capital adequacy, technical expertise and risk tolerance. It should take into account the size, nature and complexities of the banking institution's business plans and consider past experiences and performances. Procedures for defining and reviewing the institutions' business strategy should ensure that the following aspects are given adequate consideration:

a. the institution's inherent strengths;
b. its identified weaknesses;
c. opportunities external to the institution; and
d. external factors that pose threats to the institution.

Where appropriate, strategic risk management policies and procedures should cover the use of risk mitigation techniques

A set of Board approved limits should be put in place to control a banking institution's exposure to various quantifiable risks associated with its strategic plan. Risk limits should be clearly communicated to the business units and understood by the relevant staff.

The Board or its designated committee should ensure that limits are subject to regular review and are assessed in light of changes in market conditions or business strategy.

The bank's limits should at least define the following:

a. exposure to different sectors of the economy;
b. growth of business and staff strength; and
c. network expansion programmes.

Section 4 RISK MONITORING AND MANAGEMENT INFORMATION SYSTEM

In order to ensure an effective strategic risk management process, every institution should deploy a management information system that enables management to identify and measure the risks associated with the banking institution's strategic plan. The level of sophistication of the system should depend on the nature, scale and complexity of the business segments within the business plan of the banking institution. In general the MIS should enable management to monitor:

4.1 current and forecasted economic conditions, e.g., economic growth, inflation, foreign exchange trends, etc.

4.2 current and forecasted industry and market conditions, such as:

  a. increasing competition by new market entrants
  b. number and size of mergers and acquisitions

c. changing customer behaviour
d. new products/substitutes

4.3 exposure to different sectors, and associated sector risks

4.4 mechanisms that are in place to detect exceptions to limits and guidelines

Reporting should be frequent enough to provide timely and adequate information to judge the changing nature of the banking institution's strategic risk profile and evaluate compliance with stated policy objectives and constraints.

To remain effective, the banking institution should review its MIS regularly, and subject it to regular upgrades and modifications.

Section 5 INTERNAL CONTROLS AND AUDIT

A banking institution's internal control structure is critical to the safe and sound functioning of the organization generally and the management of the banking institution's strategic direction in particular. Banking institutions need strong internal control systems to ensure that they are not unduly exposed to strategic risks. Internal controls are required to ensure that:

1. the organization's structure establishes clear lines of authority;
2. the systems and structures provide for business continuity planning; and
3. the process of setting up and reviewing strategic and business plans are comprehensive and carefully adhered to.

Internal and external audits are integral to the implementation of a risk management process to control risk associated with a banking institution's business strategy. To carry out their function effectively, internal auditors should have appropriate independence and status within the banking institution to ensure that senior management reacts to and acts upon their recommendations.

A banking institution's internal audit function should among other things, perform periodic checking on whether the strategic risk management system is properly implemented and the established policies and control procedures in respect of risk management are complied with.

The risk management process and the related internal controls should be examined and tested periodically. The scope and frequency of audit may vary but should be increased if there are significant weaknesses or major changes or new products are introduced.

Section 1 INTRODUCTION

Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the institution.

Credit risk arises from on balance sheet claims such as loans and overdrafts as well as off balance sheet commitments such as guarantees, letters of credit, and derivative instruments. For most institutions, loans are the largest and most obvious source of credit risk.

In addition, an institution may also be exposed to credit risk when dealing with foreign exchange operations. This may arise when a domestic borrower involved in export business fails to compete in foreign markets due to domestic currency appreciation and thus resulting in inability to repay the domestic loan.

In an institution's portfolio, losses stem from outright default due to inability or unwillingness of a customer or counter party to meet commitments in relation to lending, trading, settlement and other financial transactions. Alternatively, losses may result from reduction in portfolio value due to actual or perceived deterioration in credit quality. Credit risk emanates from an institution's dealing with individuals, corporate, financial institutions or a sovereign.

Credit risk not necessarily occurs in isolation. The same source that endangers credit risk for the institution may also expose it to other risk. For instance a bad portfolio may attract liquidity problems.

Common sources of credit problems are:

1.1 Credit concentrations

These are viewed as any exposure where the potential losses are large relative to the institution's capital, its total assets or, where adequate measures exist, the institution's overall risk level.

This may be in the form of single borrowers or counterparties, a group of connected counterparties, and sectors or industries, such as trade, agriculture, etc or in the form of common or correlated factors e.g. the Asian crisis demonstrated how close linkages among emerging markets under stress situations and correlation between market and credit risks as well as between those risks and liquidity risk, can produce widespread losses.

1.2 Credit process issues

Many credit problems reveal basic weaknesses in the credit granting and monitoring processes. While shortcomings in underwriting and management of credit exposures represent important sources of losses in institutions, many credit problems would have been avoided or mitigated by a strong internal credit process.

Section 2 BOARD AND SENIOR MANAGMENT OVERSIGHT

2.1 Board Oversight

The board of directors has a critical role to play in overseeing the credit-granting and credit risk management functions of the institution. It is the overall responsibility of institution's board to approve institution's credit risk strategy and significant policies relating to credit risk and its management which should be based on the institution's overall business strategy. To keep them current, the overall policies have to be reviewed by the Board, at least annually. The responsibilities of the Board with regard to credit risk management shall, *inter alia*, include:

a. describing the institution's overall risk tolerance in relation to credit risk;

b. ensuring that institution's significant credit risk exposure is maintained at prudent levels and consistent with the available capital;

c. setting up the overall lending authority structure and explicitly delegate credit sanctioning authority, where appropriate, to senior management and the credit committee;

d. ensuring that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge to accomplish the risk management function;

e. ensuring that the institution implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk;

f. ensuring that appropriate plans and procedures for credit risk management are in place;

g. ensuring that internal audit reviews the credit operations to assess whether or not the institution's policies and procedures are adequate and being adhered to;

h. reviewing exposures to insiders and their related parties, including policies related thereto;

I. ratifying exposures exceeding the level of the management authority delegated to management and be aware of exposures that are not within the ambits of existing credit policies of the institution;

j. reviewing trends in portfolio quality and the adequacy of institution's provision for credit losses; and,

k. outlining the content and frequency of management report to the board on credit risk management.

2.2 Senior Management Oversight

The senior management is responsible for implementing institution's credit risk management strategies and policies and ensuring that the procedures are put in place to manage and control credit risk and the quality of credit portfolio in accordance with these policies. The responsibilities of the senior management with regard to credit risk management shall include:

a. developing credit policies and credit administration procedures as a part of overall credit risk management framework for approval by the board;

b. implementing credit risk management policies;

c. ensuring the development and implementation of appropriate reporting system with respect to the content, format, and frequency of information concerning the credit portfolio and the credit risk to permit the effective analysis and the sound and prudent management and control of existing and potential credit risk exposure;

d. monitoring and controlling the nature and composition of the institution's portfolio;

e. monitoring the quality of credit portfolio and ensuring that portfolio is soundly and conservatively valued, uncollectible exposure written off and probable losses adequately provided for;

f. establishing internal controls including putting in place clear lines of accountability and authority to ensure effective credit risk management process; and

g. developing lines of communications to ensure the timely dissemination of credit risk management policies, procedures and other credit risk management information to all individuals involved in the process.

Section 3 STRATEGY, POLICIES, PROCEDURES AND LIMITS

3.1 Credit Strategy

The very first purpose of institution's credit strategy is to determine the risk appetite of the institution. Once it is determined the institution could develop a plan to optimize return while keeping credit risk within predetermined limits.

The institution's credit risk strategy thus should spell out:

a. the institution's plan to grant credit based on various client segments and products, economic sectors, geographical location, currency and maturity;

b. target market within each lending segment and level of diversification/concentration; and

c. pricing strategy.

It is essential that institutions give due consideration to their target market while devising credit risk strategy. The credit procedures should aim to obtain an in depth understanding of the institution's clients, their credentials & their businesses in order to fully know their customers.

The strategy should provide continuity in approach and take into account cyclic aspect of country's economy and the resulting shifts in composition and quality of overall credit portfolio. While the strategy would be reviewed periodically and amended, as deemed necessary, it should be viable in long term and through various economic cycles.

3.2 Credit Policies

Credit policies establish framework for the making of investment and lending decisions and reflect an institution's tolerance for credit risk. To be effective, policies should be communicated in a timely fashion, and should be implemented through all levels of the institution by appropriate procedures. Any significant deviation/exception to these policies must be communicated to the senior management/board and corrective measures should be taken.

At minimum, credit policies should include:

a. general areas of credit in which the institution is prepared to engage or is restricted from engaging such as type of credit facilities, type of collateral security, types of borrowers, geographical areas or economic sectors on which the institution may focus on;

b. detailed and formalized credit evaluation/appraisal process, administration and documentation;

c. credit approval authority at various hierarchy levels including authority for approving exceptions such as credit extension beyond prescribed limits;

d. concentration limits on single counterparties and groups of connected counterparties, particular industries or economic sectors, geographical areas and specific products. Institutions should ensure that their own internal exposure limits comply with any prudential limits or restrictions set by BSP;

e. authority for approval of allowance for probable losses and rite-offs;

f. credit pricing;

g. roles and responsibilities of units/staff involved in origination and management of credit;

h. guidelines on management of problem loans; and

I. the credit policy should explicitly provide guidance for internal rating systems including definition of each risk grade; criteria to be fulfilled while assigning a particular grade, as well as the circumstances under which deviations from criteria can take place.

In order to be effective, credit policies must be communicated throughout the institution, implemented through appropriate procedures, and periodically revised to take into account changing internal and external circumstances.

3.3 Credit Procedures

a. *Credit Origination*

Establishing sound, well-defined credit-granting criteria is essential to approving credit in a safe and sound manner. The criteria should set out who is eligible for credit and for how much, what types of credit are available, and under what terms and conditions the credits should be granted.

Institutions must receive sufficient information to enable a comprehensive assessment of the true risk profile of the borrower or counterparty. At minimum, the factors to be considered and documented in approving credits must include:

(1) the purpose of the credit and source of repayment;

(2) the integrity and reputation of the borrower or counterparty;

(3) the current risk profile (including the nature and aggregate amounts of risks) of the borrower or counterparty and its sensitivity to economic and market developments;

(4) the borrower’s repayment history and current capacity to repay, based on historical financial trends and cash flow projections;

(5) a forward-looking analysis of the capacity to repay based on various scenarios;

(6) the legal capacity of the borrower or counterparty to assume the liability;

(7) for commercial credits, the borrower’s business expertise and the status of the borrower’s economic sector and its position within that sector;

(8) the proposed terms and conditions of the credit, including covenants designed to limit changes in the future risk profile of the borrower; and

(9) where applicable, the adequacy and enforceability of collateral or guarantees.

Once credit-granting criteria have been established, it is essential for the institution to ensure that the information it receives is sufficient to make proper credit-granting decisions.

This information may also serve as the basis for rating the credit under the institution's internal rating system.

Institutions need to understand to whom they are granting credit. Therefore, prior to entering into any new credit relationship, institutions must become familiar with the borrower or counterparty and be confident that they are dealing with an individual or organization of sound repute and creditworthiness.

In particular, strict policies must be in place to avoid association with individuals involved in fraudulent activities and other crimes. This can be achieved through a number of ways, including asking for references from known parties, accessing credit reference bureau, and becoming familiar with individuals responsible for managing a company and checking their personal references and financial condition. However, institutions should not grant credit simply because the borrower or counterparty is familiar to them or is perceived to be highly reputable.

Institutions should have procedures to identify situations where, in considering credits, it is appropriate to classify a group of borrowers as connected counterparties and, thus, as a single borrower. This would include aggregating exposures to groups of accounts, corporate or non-corporate, under common ownership or control or with strong connecting links (for example, common management, family ties).

In loan syndications, participants should perform their own independent credit risk analysis and review of syndicate terms prior to committing to the syndication. Each institution should analyze the risk and return on syndicated loans in the same manner as other loans.

Institutions should assess the risk/return relationship in any credit as well as the overall profitability of the account relationship. Credits should be priced in such a way as to cover all of the embedded costs and compensate the institution for the risks incurred. In evaluating whether, and on what terms, to grant credit, institutions need to assess the risks against expected return, factoring in, to the greatest extent possible, price and non-price (e.g. collateral, restrictive covenants, etc.) terms.

In evaluating risk, institutions should also assess likely downside scenarios and their possible impact on borrowers or counterparties. A common problem among institutions is the tendency not to price a credit or overall relationship properly and therefore not receive adequate compensation for the risks incurred.

In considering potential credits, institutions must recognize the necessity of establishing provisions for expected losses and holding adequate capital to absorb risks and unexpected losses. Institutions should factor these considerations into credit-granting decisions, as well as into the overall portfolio monitoring process.

Institutions can utilize credit risk mitigants such as collateral, guarantees, and credit derivatives or on balance sheet netting to help mitigate risks inherent in individual credits. However, credit transactions should be entered into primarily on the strength of the borrower's repayment capacity.

Credit risk mitigants should not be a substitute for a comprehensive assessment of the borrower or counterparty, nor can it compensate for insufficient information. It should be recognized that any credit enforcement actions (e.g. foreclosure proceedings) typically eliminate the profit margin on the transaction.

In addition, institutions need to be mindful that the value of collateral may well be impaired by the same factors that have led to the diminished recoverability of the credit.

Institutions should have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable.

With regard to guarantees, institutions should evaluate the level of coverage being provided in relation to the credit-quality and legal capacity of the guarantor. Institutions should only factor explicit guarantees into the credit decision and not those that might be considered implicit such as anticipated support from the government.

b. *New Credits and Extension of Existing Credits*

In order to maintain a sound credit portfolio, institutions must have an established formal evaluation and approval process for the granting of credits.

Approvals should be made in accordance with the institution's written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as making the credit decision.
Each credit proposal should be subject to careful analysis by a credit analyst with expertise commensurate with the size and complexity of the transaction.

An effective evaluation process establishes minimum requirements for the information on which the analysis is to be based. There should be policies in place regarding the information and documentation needed to approve new credits, renew existing credits and/or change the terms and conditions of previously approved credits. The information received will be the basis for any internal evaluation or rating assigned to the credit and its accuracy and adequacy is critical to management making appropriate judgments about the acceptability of the credit.

An institution's credit-granting approval process should establish accountability for decisions taken and designate who has the authority to approve credits or changes in credit terms.

A potential area of abuse arises from granting credit to connected and related parties, whether companies or individuals. Consequently, it is important that institutions grant credit to such parties on an arm's-length basis and that the amount of credit granted is monitored. Such controls should be implemented by requiring that the terms and conditions of such credits not be more favourable than credit granted to non-related borrowers under similar circumstances and by imposing strict limits on such credits.

Transactions with related parties should be subject to the approval of the board of directors. Any board member who stands to benefit from that transaction should not be part of the approval process.

3.4 Credit Limit Setting

An important element of credit risk management is to establish exposure limits for individual borrowers and counterparties and group of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book as well as on and off balance sheet.

Institutions are expected to develop its own limit structure while remaining within the exposure limits set by the Bangko Sentral ng Pilipinas (BSP).

The size of the limits should be based on the credit strength of the counterparty, genuine requirement of credit, economic conditions and the institution's risk tolerance. Limits should also be set for respective products, activities, specific industry, economic sectors and/or geographic regions to avoid concentration risk.

Credit limits should be reviewed regularly at least annually or more frequently if counterparty's credit quality deteriorates. All requests of increase in credit limits should be substantiated.

Section 4 RISK MEASUREMENT, MONITORING AND MANAGEMENT INFORMATION SYSTEMS

4.1 Measurement and Monitoring

Institutions should have methodologies that enable it to quantify the risk involved in exposures to individual borrowers or counterparties. Institutions should also be able to analyze credit risk at the product and portfolio level in order to identify any particular sensitivities or concentrations. The measurement of credit risk should take account of the following:

a. the specific nature of the credit (loan, derivative, etc.) and its contractual and financial conditions (maturity, interest rate, etc);

b. the exposure profile until maturity in relation to potential market movements;

c. the existence of collateral or guarantees; and,

d. the potential for default based on the internal risk rating.

The analysis of credit risk data should be undertaken at an appropriate frequency with the results reviewed against relevant limits. Institutions should use measurement techniques that are appropriate to the complexity and level of the risks involved in their activities, based on robust data, and subject to periodic validation.

Institution's management should conduct periodic stress tests of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could adversely impact their performance.

4.2 Credit Administration

Credit administration is a critical element in maintaining the safety and soundness of an institution.

Once a credit is granted, it is the responsibility of the business function, often in conjunction with a credit administration support team, to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements. In developing its credit administration areas, institutions should ensure:

a. the efficiency and effectiveness of credit administration operations, including monitoring, documentation, contractual requirements, legal covenants, collateral, etc;

b. the accuracy and timeliness of information provided to management information systems;

c. the adequacy of controls over all back office procedures; and,

d. compliance with prescribed policies and procedures as well as applicable laws and regulations.

For the various components of credit administration to function appropriately, senior management must understand and demonstrate that it recognizes the importance of this element of monitoring and controlling credit risk.

The credit files should include all of the information necessary to ascertain the current financial condition of the borrower or counterparty as well as sufficient information to track the decisions made and the history of the credit.

Institutions need to develop and implement comprehensive procedures and information systems to monitor the condition of individual credits and single obligors across the institution's various portfolios. These procedures need to define criteria for identifying and reporting potential problem credits and other transactions to ensure that they are subject to more frequent monitoring as well as possible corrective action, classification and/or provisioning.

An effective credit monitoring system will include measures to:

a. ensure that the institution understands the current financial condition of the borrower or counterparty;

b. ensure that all credits are in compliance with existing covenants;

c. follow up of customer's utilization of the approved credit lines;

d. ensure that projected cash flows on major credits meet debt servicing requirements;

e. ensure that, where applicable, collateral provides adequate coverage relative to the obligor's current condition; and

f. identify and classify potential problem credits on a timely basis.

Institutions need to enunciate a system that enables it to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable CSBI to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance of regulatory limits.

Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends. Consequently, the management could fine tune or reassess its credit strategy/policy accordingly before encountering any major setback. Institution's credit policy should explicitly provide procedural guideline relating to credit risk monitoring.

At the minimum, such policy should lay down procedures relating to:

a. the roles and responsibilities of individuals responsible for credit risk monitoring;

b. the assessment procedures and analysis techniques (for individual loans & overall portfolio);

c. the frequency of monitoring;

d. the periodic examination of collaterals and covenants;

e. the frequency of site visits; and,

f. the identification of any deterioration in any loan.

4.3 Internal Risk Rating and Provisioning

An important tool in monitoring the quality of individual credits, as well as the total portfolio, is the use of an internal risk rating system.

A well-structured internal risk rating system is a good means of differentiating the degree of credit risk in the different credit exposures of an institution. This will allow more accurate determination of the overall characteristics of the credit portfolio, concentrations, problem credits, and the adequacy of loan loss reserves.

In determining loan loss reserves, institutions should ensure that BSP classifications criteria are the minimum.

Typically, an internal risk rating system categorizes credits into various classes designed to take into account the gradations in risk. Simpler systems might be based on several categories ranging from satisfactory to unsatisfactory; however, more meaningful systems will have numerous gradations for credits considered satisfactory in order to truly differentiate the relative credit risk they pose.

In developing their systems, institutions must decide whether to rate the riskiness of the borrower or counterparty, the risks associated with a specific transaction, or both.

Internal risk ratings are an important tool in monitoring and controlling credit risk. In order to facilitate early identification, the institution's internal risk rating system should be responsive to indicators of potential or actual deterioration in credit risk e.g. financial position and business condition of the borrower, conduct of the borrower's accounts, adherence to loan covenants, value of collateral, etc.

Credits with deteriorating ratings should be subject to additional oversight and monitoring, for example, through more frequent visits from credit officers and inclusion on a watch list that is regularly reviewed by senior management.

The internal risk ratings can be used by line management in different departments to track the current characteristics of the credit portfolio and help determine necessary changes to the credit strategy of the institution.

Consequently, it is important that the board of directors and senior management also receive periodic reports on the condition of the credit portfolios based on such ratings.

The ratings assigned to individual borrowers or counterparties at the time the credit is granted must be reviewed on a periodic basis and individual credits should be assigned a new rating when conditions either improve or deteriorate. Because of the importance of ensuring that internal ratings are consistent and accurately reflect the quality of individual credits, responsibility for setting or confirming such ratings should rest with a credit review function independent of that which originated the credit concerned. It is also important that the consistency and accuracy of ratings is examined periodically by a function such as an independent credit review group.

4.4 Managing Problem Credits

An institution should establish a system that helps identify problem loan ahead of time when there may be more options available for remedial measures.

Once the loan is identified as problem, it should be managed under a dedicated remedial process. Responsibility for such credits may be assigned to the originating business function, a specialized workout section, or a combination of the two, depending upon the size and nature of the credit and the reason for its problems. When an institution has significant credit-related problems, it is important to segregate the workout function from the credit origination function. The additional resources, expertise and more concentrated focus of a specialized workout section normally improve collection results.

A problem loan management process encompasses the following basic elements:

a. *Negotiation and follow-up*

Proactive effort should be taken in dealing with obligors to implement remedial plans, by maintaining frequent contact and internal records of follow-up actions. Often rigorous efforts made at an early stage prevent institutions from litigations and loan losses.

b. *Workout remedial strategies*

Sometimes, appropriate remedial strategies such as restructuring of loan facility, enhancement in credit limits or reduction in interest rates help improve obligor’s repayment capacity.

However, it depends upon business condition, the nature of problems being faced and most importantly obligor's commitment and willingness to repay the loan.

While such remedial strategies often bring up positive results, institutions need to exercise great caution in adopting such measures and ensure that such a policy must not encourage obligors to default intentionally. The institution's interest should be the primary consideration in case of such workout plans. It is important that competent authority approves such workout plans before their implementation.

c. *Review of collateral and security documents*

Institutions have to ascertain the loan recoverable amount by updating the values of available collateral with formal valuation. Security documents should also be reviewed to ensure the completeness and enforceability of contracts and collaterals/guarantees.

d. Status Report and Review

Problem credits should be subject to more frequent review and monitoring. The review should update the status and development of the loan accounts and progress of the remedial plans. Progress made on problem loans should be reported to the senior management.

4.5 Management Information System

The effectiveness of an institution's credit risk measurement process is highly dependent on the quality of management information systems. The information generated from such systems enables the board and all levels of management to fulfill their respective oversight roles, including determining the adequate level of capital that the institution should be holding. Therefore, the quality, detail and timeliness of information are critical.

In particular, information on the composition and quality of the various portfolios, including on a consolidated basis, should permit management to assess quickly and accurately the level of credit risk that the institution has incurred through its various activities and determine whether the institution's performance is meeting the credit risk strategy.

It is also important that institutions have a management information system in place to ensure that exposures approaching risk limits are brought to the attention of senior management. All exposures should be included in a risk limit measurement system. The institution's information system should be able to aggregate credit exposures to individual borrowers and counterparties and report on exceptions to credit risk limits on a meaningful and timely basis.

Institutions should have information systems in place that enable management to identify any concentrations of risk within the credit portfolio. The adequacy of scope of information should be reviewed on a periodic basis by business line managers, senior management and the board of directors to ensure that it is sufficient to the complexity of the business.

Section 5 INTERNAL CONTROLS / RISK REVIEWS

Institutions must establish a mechanism of independent, ongoing assessment of credit risk management process. The purpose of such review is to assess the credit administration process, the accuracy of credit rating including adequacy of provisions for losses, and overall quality of credit portfolio. All facilities should be subjected to risk review at least quarterly.

The results of such review should be properly documented and reported directly to the Board of Directors, or Senior Management, as applicable.

Institutions should conduct credit review with updated information on the obligor's financial and business conditions, as well as conduct of account. Exceptions noted in the credit monitoring process should also be evaluated for impact on the obligor's creditworthiness. Credit review should also be conducted on a consolidated group basis to factor in the business connections among entities in a borrowing group.

As stated earlier, credit review should be performed on quarterly basis, however more frequent review should be conducted for new accounts where institutions may not be familiar with the obligor, and for classified or adverse rated accounts that have higher probability of default.

Section 1 INTRODUCTION

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses.

Liquidity risk is considered a major risk for institutions. It arises when the cushion provided by the liquid assets are not sufficient enough to meet maturing obligations. In such a situation institutions often meet their liquidity requirements from the market. However conditions of funding through the market depend upon liquidity in the market and borrowing institution's creditworthiness.

Accordingly, an institution short of liquidity may have to undertake transactions at heavy cost resulting in a loss of earnings or in worst case scenario, the liquidity risk could result in bankruptcy of the institution if it is unable to undertake transactions even at current market prices.

Institutions with large off-balance sheet exposures or institutions, which rely heavily on large corporate deposits, have relatively high level of liquidity risk. Further, institutions experiencing a rapid growth in assets should have major concerns for liquidity.

Liquidity risk should not be seen in isolation, because financial risks are not mutually exclusive and liquidity risk is often triggered by consequences of other financial risks such as credit risk, interest rate risk, foreign exchange risk, etc. For instance, an institution increasing its credit risk through asset concentration may be increasing its liquidity risk as well. Similarly a large loan default or changes in interest rate can adversely impact an institution's liquidity position.

Further, if management misjudges the impact on liquidity of entering into a new business or product line, the institution's strategic risk would increase.

An incipient liquidity problem may initially reveal in the institution's financial monitoring system as a downward trend with potential long-term consequences for earnings or capital. Given below are some early warning indicators that may not necessarily always lead to liquidity problem for an institution; however, these have potential to ignite such a problem. Consequently, management needs to watch carefully such indicators and exercise further scrutiny/analysis wherever it deems appropriate.

Examples of such internal indicators are:

1. A negative trend or significantly increased risk in any area or product line;
2. Concentrations in either assets or liabilities;
3. Deterioration in quality of credit portfolio;
4. A decline in earnings performance or projections;
5. Rapid asset growth funded by volatile large deposit;
6. A large size of off-balance sheet exposure; and
7. Deteriorating third party evaluation about the institution.

Liquidity risk management involves not only analyzing institutions on and off-balance sheet positions to forecast future cash flows, but also how the funding requirement would be met. The latter involves identifying the funding market the institution has access to, understanding the nature of those markets, evaluating institutions current and future use of the market and monitor signs of confidence erosion.

The formality and sophistication of risk management processes established to manage liquidity risk should reflect the nature, size and complexity of an institution's activities.

Sound liquidity risk management employed in measuring, monitoring and controlling liquidity risk is critical to the viability of any institution.

Institutions should have a thorough understanding of the factors that could give rise to liquidity risk and put in place mitigating controls.

Section 2 BOARD AND SENIOR MANAGEMENT OVERSIGHT

2.1 Board Oversight

The prerequisites of an effective liquidity risk management include an informed board, capable management, staff having relevant expertise and efficient systems and procedures. It is primarily the duty of board of directors to understand the liquidity risk profile of the institution and the tools used to manage liquidity risk. The board has to ensure that the institution has necessary liquidity risk management framework and the institution is capable of dealing with uneven liquidity scenarios.

The board should approve the strategy and significant policies related to the management of liquidity.

Generally speaking responsibilities of the board include:

a. providing guidance on the level of tolerance for liquidity risk;

b. appointing senior managers who have ability to manage liquidity risk and delegate to them the required authority to accomplish the job;

c. continuously monitoring the institution's performance and overall liquidity risk profile through reviewing various reports; and,

d. ensuring that senior management takes the steps necessary to identify, measure, monitor and control liquidity risk.

2.2 Senior Management Oversight

Senior management is responsible for the implementation of sound policies and procedures keeping in view the strategic direction and risk appetite specified by the board.

To effectively oversee the daily and long-term management of liquidity risk, senior managers should:

a. develop and implement procedures and practices that translate the board's goals, objectives, and risk tolerances into operating standards that are well understood by institution personnel and consistent with the board's intent;

b. adhere to the lines of authority and responsibility that the board has approved for managing liquidity risk;

c. oversee the implementation and maintenance of management information and other systems that identify, measure, monitor, and control the institution's liquidity risk; and,

d. establish effective internal controls over the liquidity risk management process and ensure that the same is communicated to all staff.

2.3 Liquidity Management Structure

The responsibility for managing the overall liquidity of the institution should be delegated to a specific, identified group within the institution. This may be in the form of an Asset Liability Committee (ALCO) comprised of senior management or the treasury function.

Since liquidity management is a technical job requiring specialized knowledge and expertise, it is important that responsible officers not only have relevant expertise but also have a good understanding of the nature and level of liquidity risk assumed by the institution and the means to manage that risk. It is critical that there be close links between those individuals responsible for liquidity and those monitoring market conditions, as well as other individuals with access to critical information. This is particularly important in developing and analyzing stress scenarios.

Section 3 STRATEGY, POLICIES, PROCEDURES AND LIMITS

3.1 Liquidity Risk Strategy

Each institution should have an agreed liquidity strategy for the day-to-day management of liquidity. The strategy should set out the general approach the institution will have to liquidity, including various quantitative and qualitative targets. This strategy should address the institution's goal of protecting financial strength and the ability to withstand stressful events in the market place.

The liquidity risk strategy defined by board should enunciate specific policies on particular aspects of liquidity risk management, such as:

a. *Composition of Assets and Liabilities*

The strategy should outline the mix of assets and liabilities to maintain liquidity. Liquidity risk management and asset/liability management should be integrated to avoid high costs associated with having to rapidly reconfigure the asset liability profile from maximum profitability to increased liquidity.

b. *Diversification and Stability of Liabilities*

A funding concentration exists when a single decision or a single factor has the potential to result in a significant and sudden withdrawal of funds. Since such a situation could lead to an increased risk, the board of directors and senior management should specify guidance relating to funding sources and ensure that the institution has diversified sources of funding day-to-day liquidity requirements. An institution would be more resilient to tight market liquidity conditions if its liabilities were derived from more stable sources.

To comprehensively analyze the stability of liabilities/funding sources the institution need to identify:

(1) liabilities that would stay with the institution under any circumstances;

(2) liabilities that run-off gradually if problems arise; and

(3) liabilities that run-off immediately at the first sign of problems.

c. *Managing Liquidity in Different Currencies*

The institution should have a strategy on how to manage liquidity in different currencies.

d. *Dealing with Liquidity Disruptions*

The institution should put in place a strategy on how to deal with the potential for both temporary and long-term liquidity disruptions.

The strategy should take into account the fact that in crisis situations access to interbank market could be difficult as well as costly.

The liquidity strategy must be documented in a liquidity policy, and communicated throughout the institution.

The strategy should be evaluated periodically to ensure that it remains valid.

3.2 Liquidity Risk Policies

Board of directors should ensure that there are adequate policies to govern liquidity risk management process.

While specific details vary across institutions according to the nature of their business, the key elements of any liquidity policy include:

a. general liquidity strategy (short- and long-term), specific goals and objectives in relation to liquidity risk management, process for strategy formulation and the level within the institution it is approved;

b. roles and responsibilities of individuals performing liquidity risk management functions, including structural balance sheet management, pricing, marketing, contingency planning, management reporting, lines of authority and responsibility for liquidity decisions;

c. liquidity risk management tools for identifying, measuring, monitoring and controlling liquidity risk (including the types of liquidity limits and ratios in place and rationale for establishing limits and ratios); and

d. contingency plan for handling liquidity crises.

To be effective, the liquidity policy must be communicated down the line throughout the institution. It is important that the board and senior management ensure that policies are reviewed at least annually and when there are any material changes in the institution's current and prospective liquidity risk profile. Such changes could stem from internal circumstances (e.g. changes in business focus) or external circumstances (e.g. changes in economic conditions).

Reviews provide the opportunity to fine-tune the institution's liquidity policies in light of the institution's liquidity management experience and development of its business. Any significant or frequent exception to the policy is an important barometer to gauge its effectiveness and any potential impact on institution's liquidity risk profile.

3.3 Procedures and Limits

Institutions should establish appropriate procedures, processes and limits to implement their liquidity policies.

The procedural manual should explicitly narrate the necessary operational steps and processes to execute the relevant liquidity risk controls. The manual should be periodically reviewed and updated to take into account new activities, changes in risk management approaches and systems.

Section 4 RISK MEASUREMENT, MONITORING AND MANAGEMENT INFORMATION SYSTEMS

Besides the institutional structure discussed earlier, an effective liquidity risk management include systems to identify, measure, monitor and control its liquidity exposures.

Management should be able to accurately identify and quantify the primary sources of an institution's liquidity risk in a timely manner. To properly identify the sources, management should understand both existing as well as future risk that the institution can be exposed to. Management should always be alert for new sources of liquidity risk at both the transaction and portfolio levels.

Key elements of an effective risk management process include an efficient MIS to measure, monitor and control existing as well as future liquidity risks and reporting them to senior management and the board of directors.

As far as information system is concerned various units related to treasury activities and risk management function should be integrated.

Furthermore, management should ensure proper and timely flow of information among front office, back office and middle office in an integrated manner; however, their reporting lines should be kept separate to ensure independence of these functions.

Periodic reviews should be conducted to determine whether the institution complies with its liquidity risk policies and procedures. Positions that exceed established limits should receive prompt attention of appropriate management and should be resolved according to the process described in approved policies. Periodic reviews of the liquidity management process should also address any significant changes in the nature of instruments acquired, limits, and internal controls that have occurred since the last review.

4.1 Measurement and Monitoring of Liquidity Risk

An effective measurement and monitoring process is essential for adequately managing liquidity risk. At a very basic level, liquidity measurement involves assessing all of an institution's cash inflows against its outflows to identify the potential for any net shortfalls going forward. This includes funding requirements for off-balance sheet commitments.

A number of techniques can be used for measuring liquidity risk, ranging from simple calculations and static simulations based on current holdings to highly sophisticated modeling techniques. As all institutions are affected by changes in the economic climate and market conditions, the monitoring of economic and market trends is key to liquidity risk management.

An important aspect of managing liquidity is making assumptions about future funding needs. While certain cash inflows and outflows can be easily calculated or predicted, institutions must also make assumptions about future liquidity needs, both in the very short-term and for longer time periods.

One important factor to consider is the critical role an institution's reputation plays in its ability to access funds readily and at reasonable terms.

For that reason, institution staff responsible for managing overall liquidity should be aware of any information (such as an announcement of a decline in earnings or a downgrading by a rating agency) that could have an impact on market and public perceptions about the soundness of the institution.

An effective liquidity risk measurement and monitoring system not only helps in managing liquidity in times of crisis but also optimize return through efficient utilization of available funds. Discussed below are some commonly used liquidity measurement and monitoring techniques:

a. Contingency Funding Plans (CFP)

In order to develop comprehensive liquidity risk management framework, institutions should have in place plans to address stress scenarios. Such a plan commonly known as CFP is a set of policies and procedures that serves as a blue print for an institution to meet its funding needs in a timely manner and at a reasonable cost.

A CFP is a projection of future cash flows and funding sources of an institution under market scenarios including aggressive asset growth or rapid liability erosion. To be effective it is important that a CFP should represent management's best estimate of balance sheet changes that may result from a liquidity or credit event. A CFP can provide a useful framework for managing liquidity risk both short term and in the long term. Further, it helps to ensure that a financial institution can prudently and efficiently manage routine and extraordinary fluctuations in liquidity. The scope of the CFP is discussed in more detail below. For day-to-day liquidity risk management integration, liquidity scenarios will ensure that the institution is best prepared to respond to an unexpected problem. In this sense, a CFP is an extension of ongoing liquidity management and formalizes the objectives of liquidity management by ensuring:

(1) a reasonable amount of liquid assets are maintained;

(2) measurement and projection of funding requirements during various scenarios; and

(3) management of access to funding sources.

It is not always that liquidity crisis shows up gradually. In case of a sudden liquidity stress, it is important for an institution to be seen organized, candid, and efficient to meet its obligations to the stakeholders. Since such a situation requires a spontaneous action, institutions that already have plans to deal with such situation could address the liquidity problem more efficiently and effectively.

A CFP can help ensure that institution management and key staff are ready to respond to such situations. Institution liquidity is very sensitive to negative trends in credit, capital, or reputation. Deterioration in the institution's financial condition (reflected in items such as asset quality indicators, earnings, or capital), management composition, or other relevant issues may result in reduced access to funding.

The sophistication of a CFP depends upon the size, nature, complexity of business, risk exposure, and institutional structure. To begin, the CFP should anticipate all of the institution's funding and liquidity needs by:

(1) Analyzing and making quantitative projections of all significant on and off balance sheet funds flows and their related effects;

(2) Matching potential cash flow sources and uses of funds; and

(3) Establishing indicators that alert management to a predetermined level of potential risks.

The CFP should project the institution's funding position during both temporary and long-term liquidity changes, including those caused by liability erosion. The CFP should explicitly identify, quantify, and rank all sources of funding by preference, such as:

(1) Reducing assets;

(2) Modification or increasing liability structure; and

(3) Using other alternatives for controlling balance sheet changes.

The CFP should include asset side as well as liability side strategies to deal with liquidity crises. The asset side strategy may include: whether to liquidate surplus money market assets, when to sell liquid or longer-term assets etc. While liability side strategies specify policies such as pricing policy for funding, the institution/dealer who could assist at the time of liquidity crisis, policy for early redemption request by retail customers, etc.

A CFP should also indicate roles and responsibilities of various individuals at the time of liquidity crises and the management information system between management, ALCO, traders, and others.

This outline of the scope of a good CFP is by no means exhaustive. Institutions should devote significant time and consideration to scenarios that are most likely given their activities.

b. Maturity Ladder

A maturity ladder is a useful device to compare cash inflows and outflows both on a day-to-day basis and over a series of specified time periods.

The number of time frames in such maturity ladder is of significant importance and up to some extent depends upon the nature of institution's liabilities or sources of funds. Institutions, which rely on short term funding, will concentrate primarily on managing liquidity on very short term. Whereas, other institutions might actively manage their net funding requirement over a slightly longer period. In the short term, institution's flow of funds could be estimated more accurately and also such estimates are of more importance as these provide an indication of actions to be taken immediately.

Further, such an analysis for distant periods will maximize the opportunity for the institution to manage the gap well in advance before it crystallizes.

Consequently, institutions should use short time frames to measure near term exposures and longer time frames thereafter. It is suggested that institutions calculate daily gap for next one or two weeks, monthly gap for next six months or a year and quarterly thereafter.

While making an estimate of cash flows, the following aspects need attention:

(1) the funding requirement arising out of off- balance sheet commitments also need to be accounted for;

(2) many cash flows associated with various products are influenced by interest rates or customer behavior. Institutions need to take into account behavioral aspects instead of contractual maturity. In this respect past experiences could give important guidance to make any assumption;

(3) some cash flows may be seasonal or cyclical; and

(4) management should also consider increases or decreases in liquidity that typically occur during various phases of an economic cycle.

While the institutions should have liquidity sufficient enough to meet fluctuations in loans and deposits, as a safety measure institutions should maintain a margin of excess liquidity. To ensure that this level of liquidity is maintained, management should estimate liquidity needs in a variety of scenarios.

c. Liquidity Ratios and Limits

Institutions may use a variety of ratios to quantify liquidity. These ratios can also be used to create limits for liquidity management. However, such ratios would be meaningless unless used regularly and interpreted taking into account qualitative factors.

Ratios should always be used in conjunction with more qualitative information about borrowing capacity, such as the likelihood of increased requests for early withdrawals, decreases in credit lines, decreases in transaction size, or shortening of term funds available to the institution. To the extent that any asset-liability management decisions are based on financial ratios, an institution's asset-liability managers should understand how a ratio is constructed, the range of alternative information that can be placed in the numerator or denominator, and the scope of conclusions that can be drawn from ratios.

Because ratio components as calculated by institutions are sometimes inconsistent, ratio-based comparisons of institutions or even comparisons of periods at a single institution can be misleading.

Examples of ratios and limits that can be used are:

(1) *Liability Concentration Ratios and Limits*: Liability concentration ratios and limits help to prevent an institution from relying on too few providers or funding sources. Limits are usually expressed as a percentage of deposits or liabilities; and

(2) *Other Balance Sheet Ratios*: Total loans/total deposits, liquid assets/demand liabilities, borrowed funds/total assets, etc are examples of common ratios used by institutions to monitor current and potential funding levels.

In addition to the statutory limits of liquid assets requirement and cash reserve requirement, the board and senior management should establish limits on the nature and amount of liquidity risk they are willing to assume. The limits should be periodically reviewed and adjusted when conditions or risk tolerances change. When limiting risk exposure, senior management should consider the nature of the institution's strategies and activities, its past performance, the level of earnings, capital available to absorb potential losses, and the board's tolerance for risk.

Balance sheet complexity will determine how much and what types of limits an institution should establish over daily and long-term horizons. While limits will not prevent a liquidity crisis, limit exceptions can be early indicators of excessive risk or inadequate liquidity risk management.

4.2 Foreign Currency Liquidity Management

Each institution should have a measurement, monitoring and control system for its liquidity positions in the major currencies in which it is active. In addition to assessing its aggregate foreign currency liquidity needs and the acceptable mismatch in combination with its domestic currency commitments, an institution should also undertake separate analysis of its strategy for each currency individually.

4.3 Managing Market Access

Each institution should periodically review its efforts to establish and maintain relationships with liability holders, to maintain the diversification of liabilities, and aim to ensure its capacity to sell assets.

4.4 Review of Assumptions Utilized in Managing Liquidity

Since an institution's future liquidity position will be affected by factors that cannot always be forecast with precision, assumptions need to be reviewed frequently to determine their continuing validity, especially given the rapidity of change in the markets.

4.5 Management Information System

An effective management information system (MIS) is essential for sound liquidity management decisions.

Information should be readily available for day-to-day liquidity management and risk control, as well as during times of stress. Data should be appropriately consolidated, comprehensive yet succinct, focused and available in a timely manner. Ideally, the regular reports an institution generates will enable it to monitor liquidity during a crisis; such reports would have to be prepared more frequently under a crisis situation.

Managers should keep crisis monitoring in mind when developing liquidity MIS. There is usually a trade-off between accuracy and timeliness. Liquidity problems can arise very quickly, and effective liquidity management may require daily internal reporting. Since institution liquidity is primarily affected by large, aggregate principal cash flows, detailed information on every transaction may not improve analysis.

The management information system should be used to check for compliance with the institution's established policies, procedures and limits and with BSP's prudential requirements on liquidity. Reporting of risk measures should be done on a timely basis and compare current liquidity exposures with any set limits.

The information system should also enable management to evaluate the level of trends in the institution's aggregate liquidity exposure. Management should develop systems that can capture significant information. The content and format of reports depend on an institution's liquidity management practices, risks, and other characteristics.

Routine reports may include a list of large funds providers, a cash flow or funding gap report, a funding maturity schedule, and a limit monitoring and exception report. Day-to-day management may require more detailed information, depending on the complexity of the institution and the risks it undertakes. Management should regularly consider how best to summarize complex or detailed issues for senior management or the board.

Besides, other types of information important for managing day-to-day activities and for understanding the institution's inherent liquidity risk profile include:

a. Asset quality and its trends;
b. Earnings projections;
c. The institution's general reputation in the market and the condition of the market itself;
d. The type and composition of the overall balance sheet structure; and

e. The type of new deposits being obtained, as well as its source, maturity, and price.

Section 5 INTERNAL CONTROLS / RISK REVIEWS

Institutions should have adequate internal controls to ensure the integrity of their liquidity risk management process. These internal controls should be an integral part of the institution's overall system of internal control.

They should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with relevant laws, regulations and institutional policies. An effective system of internal control for liquidity risk includes:

1. a strong control environment;

2. an adequate process for identifying and evaluating liquidity risk;

3. the establishment of control activities such as policies and procedures;

4. adequate information systems; and,

5. continual review of adherence to established policies and procedures.

With regard to control policies and procedures, attention should be given to appropriate approval processes, limits, reviews and other mechanisms designed to provide a reasonable assurance that the institution's liquidity risk management objectives are achieved.

Many attributes of a sound risk management process, including risk measurement, monitoring and control functions, are key aspects of an effective system of internal control. Institutions should ensure that all aspects of the internal control system are effective, including those aspects that are not directly part of the risk management process.

In addition, an important element of an institution's internal control system over its liquidity risk management process is regular evaluation and review. This includes ensuring that personnel are following established policies and procedures, as well as ensuring that the procedures that were established actually accomplish the intended objectives. Such reviews and evaluations should also address any significant change that may impact on the effectiveness of controls.

The board should ensure that all such reviews and evaluations are conducted regularly by individuals who are independent of the function being reviewed.

When revisions or enhancements to internal controls are warranted, there should be a mechanism in place to ensure that these are implemented in a timely manner.

Section 1 INTRODUCTION

Market risk refers to the risk to an institution resulting from movements in market prices, in particular, changes in interest rates, foreign exchange rates, equity and commodity prices.

Market risk is often propagated by other forms of financial risks such as credit and market liquidity risks. For example, a downgrading of the credit standing of an issuer could lead to a drop in the market value of securities issued by that issuer. Likewise, a major sale of a relatively illiquid security by another holder of the same security could depress the price of the security.

The market risk factors cited above are not exhaustive. Depending on the instruments traded by an institution, exposure to other factors may also arise. The institution's consideration of market risk should capture all risk factors that it is exposed to, and it must manage these risks soundly.

Section 2 BOARD AND SENIOR MANAGEMENT OVERSIGHT

2.1 Board Oversight

The board of directors has the ultimate responsibility for understanding the nature and the level of market risk taken by the institution.

The board should approve broad business strategies and policies that govern or influence the market risk of the institution. It should review the overall objectives of the institution with respect to market risk and should ensure the provision of clear guidance regarding the level of risk acceptable to the institution. The board should also approve policies that identify lines of authority and responsibility for managing market risk exposures.

The board should ensure that senior management has sufficient knowledge and is fully capable of managing market risk including taking the steps necessary to identify, measure, monitor, and mitigate/control this risk. The board or a specific committee of the board should periodically review information that is sufficient in detail and timeliness to allow it to understand and assess the performance of senior management in monitoring and controlling market risk in compliance with the institution's board-approved policies. In addition, the board or one of its committees should periodically re-evaluate market risk management policies as well as overall business strategies that affect the market risk exposure of the institution.

The board of directors should be informed regularly of the market risk exposure of the institution in order to assess the monitoring and controlling of such risk. Using this knowledge and information, directors should provide clear guidance regarding the level of exposures acceptable to their institution.

The board should review market risk policies in order to align them with significant changes in internal and external environment. In absence of any uneven circumstances, it is expected that board would review these policies at least annually.

2.2 Senior Management Oversight

Senior management is responsible for developing policies and procedures for managing market risk on both a long-term and day-to-day basis. It should maintain clear lines of authority and responsibility for managing and controlling this risk. It should implement strategies in a manner that limits risks associated with each strategy and that ensures compliance with laws and regulations.

Management is also responsible for:

a. setting appropriate limits on risk taking;

b. developing standards for valuing positions and measuring performance;

c. comprehensive market risk reporting and management review process;

d. effective internal controls and ethical standards;

e. developing and implementing procedures and practices that translate the board's goals, objectives, and risk tolerances into operating standards that are well understood by institution personnel and consistent with the board's intent;

f. adhering to the lines of authority and responsibility that the board has established for managing foreign exchange risk; and

g. oversee the implementation and maintenance of management information and other systems that identify, measure, monitor, and mitigate/control the institution's market risk.

Market risk reports to senior management should provide aggregate information as well as sufficient supporting detail to enable management to assess the sensitivity of the institution to changes in market conditions and other important risk factors.

Senior management should also review periodically the institution's market risk management policies and procedures to ensure that they remain appropriate and sound.

Section 3 STRATEGY, POLICIES, PROCEDURES AND LIMITS

3.1 Market Risk Management Strategy

Every institution should develop a sound and well informed strategy to manage market risk. The strategy should first determine the level of market risk the institution is prepared to assume. Once its market risk tolerance is determined, the institution should develop a strategy that balances its business goals with its market risk appetite.

In setting its market risk strategy, an institution should consider the following factors:

a. economic and market conditions and their impact on market risk;

b. whether the institution has the expertise to profit in specific markets and is able to identify, monitor and control the market risk in those markets; and

c. the institution's portfolio mix and how it would be affected if more market risk was assumed.

The institution's market risk strategy should be periodically reviewed and effectively communicated to the relevant staff. There should be a process to detect deviations from the approved market risk strategy and target markets.

The board of directors and senior management should periodically review the institution's market risk strategy taking into consideration its financial performance and market developments.

3.2 Market Risk Management Policies

An institution should formulate market risk policies which should be approved by the Board. These policies should reflect the strategy of the institution, including its approach to controlling and managing market risk.

The Board should approve any changes and exceptions to these policies.

Policies should be applied on a consolidated basis and, where appropriate, to specific subsidiaries, affiliates or units within an institution. The policies should clearly:

a. prescribe how market risk is measured and communicated to the Board;

b. spell out the process by which the Board decides on the maximum market risk the institution is able to take, as well as the frequency of review of risk limits;

c. delineate the lines of authority and the responsibilities of the Board, senior management and other personnel responsible for managing market risk;

d. set out the scope of activities of the business units assuming market risk; and

e. identify and set guidelines on market risk limit structure, delegation of approving authority for market risk limit setting and limit excesses, capital requirements, and investigation and resolution of irregular or disputed transactions.

3.3 Market Risk Management Procedures

An institution should establish appropriate procedures and processes to implement the market risk policy and strategy.

These should be documented in a manual and the staff responsible for carrying out the procedures should be familiar with the content of the manual.
The manual should spell out the operational steps and processes for executing the relevant market risk controls. It should also be periodically reviewed and updated to take into account new activities, changes in systems and structural changes in the market.

The procedures should cover all activities that are exposed to market risk.

Section 4 RISK MEASUREMENT, MONITORING AND MANAGEMENT INFORMATION SYSTEMS

4.1 Processes and Systems

An institution should establish a sound and comprehensive risk management process. This should, among other things, comprise:

a. a framework to identify, measure and monitor market risk;

b. an appropriately detailed structure of risk limits, guidelines and other parameters used to govern market risk taking;

c. an appropriate management information system (MIS) for controlling, monitoring and reporting market risk, including transactions between and with related parties; and

d. accounting policies on the treatment of market risk.

An institution should incorporate its market risk management process into its overall risk management system. This would enable it to understand and manage its consolidated risk exposure more effectively. Where the institution is part of a financial services group, the risk management process should also be integrated with that of the group's where practicable.

The risk management system should be commensurate with the scope, size and complexity of an institution's trading and other financial activities and the market risks assumed. It should also enable the various market risk exposures to be accurately and adequately identified, measured, monitored and controlled.

All significant risks should be measured and aggregated on an institution-wide basis.

An institution's risk management system should be able to quantify risk exposures and monitor changes in market risk factors (e.g. changes in interest rates, foreign exchange rates, and equity prices) and other market conditions on a daily basis.

An institution whose risk levels fluctuate significantly within a trading day should monitor its risk profile on an intra-day basis. The risk management system should, wherever feasible, be able to assess the probability of future losses. It should also enable an institution to identify risks promptly and take quick remedial action in response to adverse changes in market factors.

An institution should ensure that its treasury and financial derivative valuation processes are robust and independent of its trading function. Models and supporting statistical analyses used in valuations and stress tests should be appropriate, consistently applied, and have reasonable assumptions. These should be validated before deployment. Staff involved in the validation process should be adequately qualified and independent of the trading and model development functions. Models and analyses should be periodically reviewed to ascertain the completeness of position data, the accuracy of volatility, valuation and risk factor calculations, as well as the reasonableness of the correlation and stress test assumptions.

More frequent reviews may be necessary if there are changes in models or in the assumptions resulting from developments in market conditions.

An institution should have a unit dedicated to the management of market risks. Typically this is the responsibility of the Asset Liability Management Committee (ALCO). ALCO is usually responsible for developing and maintaining appropriate risk management policies and procedures, MIS reporting, limits, and oversight programmes. It should include senior management from each functional area that assumes and manages market risks.

ALCO should meet on a frequency that is commensurate with the institution’s business activities. The terms of reference, composition, quorum and frequency of meetings should also be formalized and clearly documented.

4.2 Interest Rate Risk Measurement and Monitoring

In general, but depending on the complexity and range of activities of the individual institution, institutions should have interest rate risk measurement systems that assess the effects of rate changes on both earnings and economic value. These systems should provide meaningful measures of an institution's current levels of interest rate risk exposure, and should be capable of identifying any excessive exposures that might arise.

Measurement systems should:

a. assess all material interest rate risk associated with an institution's assets, liabilities, and OBS positions;

b. utilize generally accepted financial concepts and risk measurement techniques; and

c. have well documented assumptions and parameters.

As a general rule, it is desirable for any measurement system to incorporate interest rate risk exposures arising from the full scope of an institution's activities, including both trading and non-trading sources. This does not preclude different measurement systems and risk management approaches being used for different activities; however, management should have an integrated view of interest rate risk across products and business lines.

An institution's interest rate risk measurement system should address all material sources of interest rate risk including re-pricing, yield curve, basis and option risk exposures. In many cases, the interest rate characteristics of an institution's largest holdings will dominate its aggregate risk profile.

While all of an institution's holdings should receive appropriate treatment, measurement systems should evaluate such concentrations with particular rigor. Interest rate risk measurement systems should also provide rigorous treatment of those instruments, which might significantly affect an institution's aggregate position, even if they do not represent a major concentration.

Instruments with significant embedded or explicit option characteristics should receive special attention.

A number of techniques are available for measuring the interest rate risk exposure of both earnings and economic value. Their complexity ranges from simple calculations to static simulations using current holdings to highly sophisticated dynamic modelling techniques that reflect potential future business and business decisions. These are as follows:

a. *Maturity/re-pricing schedule*

The simplest techniques for measuring an institution's interest rate risk exposure begin with a maturity/re-pricing schedule that distributes interest-sensitive assets, liabilities and OBS positions into "time bands" according to their maturity (if fixed rate) or time remaining to their next re-pricing (if floating rate).

These schedules can be used to generate simple indicators of the interest rate risk sensitivity of both earnings and economic value to changing interest rates. When this approach is used to assess the interest rate risk of current earnings, it is typically referred to as gap analysis. The size of the gap for a given time band – that is, assets minus liabilities plus OBS exposures that re-price or mature within that time band - gives an indication of the institution's re-pricing risk exposure.

A maturity/re-pricing schedule can also be used to evaluate the effects of changing interest rates on an institution's economic value by applying sensitivity weights to each time band.

Typically, such weights are based on estimates of the duration of the assets and liabilities that fall into each time-band, where duration is a measure of the percent change in the economic value of a position that will occur given a small change in the level of interest rates.

Duration-based weights can be used in combination with a maturity/re-pricing schedule to provide a rough approximation of the change in an institution's economic value that would occur given a particular set of changes in market interest rates.

b. *Simulation Technique*

More sophisticated interest rate risk measurement systems include Simulation Techniques.

Simulation techniques typically involve detailed assessments of the potential effects of changes in interest rates on earnings and economic value by simulating the future path of interest rates and their impact on cash flows.

In static simulations, the cash flows arising solely from the institution's current on and off-balance sheet positions are assessed.

In a dynamic simulation approach, the simulation builds in more detailed assumptions about the future course of interest rates and expected changes in an institution's business activity over that time. These more sophisticated techniques allow for dynamic interaction of payments streams and interest rates, and better capture the effect of embedded or explicit options.

Regardless of the measurement system, the usefulness of each technique depends on the validity of the underlying assumptions and the accuracy of the basic methodologies used to model interest rate risk exposure.

In designing interest rate risk measurement systems, institutions should ensure that the degree of detail about the nature of their interest-sensitive positions is commensurate with the complexity and risk inherent in those positions. For instance, using gap analysis, the precision of interest rate risk measurement depends in part on the number of time bands into which positions are aggregated.

Clearly, aggregation of positions/cash flows into broad time bands implies some loss of precision. In practice, the institution must assess the significance of the potential loss of precision in determining the extent of aggregation and simplification to be built into the measurement approach.

Estimates of interest rate risk exposure, whether linked to earnings or economic value, utilize, in some form, forecasts of the potential course of future interest rates.

For risk management purposes, institutions should incorporate a change in interest rates that is sufficiently large to encompass the risks attendant to their holdings. Institutions should consider the use of multiple scenarios, including potential effects in changes in the relationships among interest rates (i.e. yield curve risk and basis risk) as well as changes in the general level of interest rates.
For determining probable changes in interest rates, simulation techniques could be used. Statistical analysis can also play an important role in evaluating correlation assumptions with respect to basis or yield curve risk.

In assessing the results of interest rate risk measurement systems, it is important that the assumptions underlying the system are clearly understood by risk managers and institution management.

In particular, techniques using sophisticated simulations should be used carefully so that they do not become "black boxes", producing numbers that have the appearance of precision, but that in fact are not very accurate when their specific assumptions and parameters are revealed. Key assumptions should be recognized by senior management and risk managers and should be re-evaluated at least annually. They should also be clearly documented and their significance understood. Assumptions used in assessing the interest rate sensitivity of complex instruments and instruments with uncertain maturities should be subject to particularly rigorous documentation and review.

4.3 Foreign Exchange Risk Measurement and Monitoring

Managing foreign exchange risk requires a clear understanding of the amount at risk and the impact of changes in exchange rates on this foreign currency exposure.

To make these determinations, sufficient information must be readily available to permit appropriate action to be taken within acceptable, often very short, time periods. Institutions may use various techniques to measure exposure to foreign exchange risk. One approach could be through setting limits on the size of the net open position in each currency in which the institution is authorized to have exposure and the aggregate of all currencies. This may be expressed as a percentage of core capital or total assets.

Other approaches could be through the use of ratios such as:

a. foreign currency assets to foreign currency liabilities;

b. change in net open position;

c. growth in international assets/liabilities; and

d. growth in off-balance sheet business.

4.4 Hedging of Foreign Exchange Risk

The use of hedging techniques is one means of managing and controlling foreign exchange risk. In this regard, many different financial instruments can be used for hedging purposes; the most commonly used, however, are derivative instruments.

Examples include forward foreign exchange contracts, foreign currency futures contracts, foreign currency options, and foreign currency swaps.

Each institution should consider which techniques are appropriate for the nature and extent of its foreign exchange risk activities, the skills and experience of management, and the capacity of foreign exchange risk reporting and control systems.

Financial instruments used for hedging are not distinguishable in form from instruments that may be used to take risk positions.

Before using hedging products, institutions must ensure that they understand the hedging technique and that they are satisfied that the instrument meets their specific hedging needs in a cost-effective manner.

Further, the effectiveness of hedging activities should be assessed not only on the basis of the technical attributes of individual transactions, but also in the context of the overall risk exposure of the institution resulting from a potential change in asset/liability mix and other risk exposures such as credit and foreign exchange risks. For example, foreign exchange swaps involve the replacement of foreign exchange risk by credit risk (the risk that the counterparty to the swap may be unable to fulfil its obligations).

In this context, hedging activities need to take place within the framework of a clear hedging strategy, the implications of which are well understood by the institution under varying market scenarios. In particular, the objectives and limitations of using hedging products should be uniformly understood, so as to ensure that hedging strategies result in an effective hedge of an exposure rather than the unintentional assumption of additional or alternate forms of risk.

Before an institution is engaged in derivative instruments, either for hedging or position-taking, it must ensure that appropriate policies and procedures, as well as the capability to implement them are in place.

4.5 Stress Testing

The market risk management process should, where appropriate, include regular scenario analysis and stress tests. An institution may choose scenarios based on either analyzing historical data or empirical models of changes in market risk factors. The objective should be to allow the institution to assess the effects of sizeable changes in market risk factors on its holdings and financial condition.

Hence, scenarios chosen could include low probability adverse scenarios that could result in extraordinary losses. Scenario analysis and stress tests should be both quantitative and qualitative.

Scenario analysis and stress testing should, as far as possible, be conducted on an institution-wide basis, taking into account the effects of unusual changes in market and non-market risk factors. Such factors include prices, volatilities, market liquidity, historical correlations and assumptions in stressed market conditions, the institution's vulnerability to worst case scenarios or the default of a large counterparty and maximum cash inflow and outflow assumptions.

Scenario analysis and stress testing would enable the Board and senior management to better assess the potential impact of various market-related changes on the institution's earnings and capital position.

The Board and senior management should regularly review the results of scenario analyses and stress testing, including the major assumptions that underpin them. The results should be considered during the establishment and review of policies and limits. Depending on the potential losses projected by the scenario analysis and stress tests and the likelihood of such losses occurring, the Board and senior management may consider additional measures to manage the risks or introduce contingency plans.

4.6 Management Information System

An accurate, informative, and timely management information system is essential for managing market risk exposure, both to inform management and to support compliance with board policy. Reporting of risk measures should be regular and should clearly compare current exposure to policy limits. In addition, past forecasts or risk estimates should be compared with actual results to identify any shortcomings.

Reports detailing the market risk exposure of the institution should be reviewed by the board on a regular basis. While the types of reports prepared for the board and for various levels of management will vary based on the institution's market risk profile, they should, at a minimum include the following:

a. summaries of the institution's aggregate market risk exposures (i.e. interest rate and foreign exchange exposures);

b. results of stress tests for market risk including those assessing breakdowns in key assumptions and parameters;

c. foreign exchange exposure reports by currency and in aggregate;

d. maturity distribution by currency of foreign currency denominated assets and liabilities including off balance sheet contingencies;

e. summaries of the findings of reviews of market risk policies, procedures, and the adequacy of the interest rate risk measurement systems, including any findings of internal and external auditors or any other independent reviewer;

f. list of outstanding contracts amounts by settlement date and currency both spot and forward;

g. reports demonstrating compliance with internal policies and prudential limits on market risk including exceptions; and

h. daily foreign exchange operations gain/loss, in comparison with previous day's results.

Section 5 INTERNAL CONTROLS / RISK REVIEWS

Institutions should have adequate internal controls to ensure the integrity of their market risk management process.

These internal controls should be an integral part of the institution's overall system of internal controls. They should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with relevant laws, regulations and institutional policies.

An effective system of internal controls for market risk should ensure that:

5.1 there is a strong control environment;

5.2 an adequate process for identifying and evaluating risk;

5.3 there are adequate control tools such as policies, procedures and methodologies; and

5.4 there is an effective management information system.

Limits for market risks that are consistent with the maximum exposures authorized by the Board and senior management should be set.

An independent risk management function should be established, with the responsibility for defining risk management policies, setting procedures for market risk identification, measurement and assessment, and monitoring the institution's compliance with established policies and market risk limits.

It should also ensure that market risk exposures are reported in a timely manner to the Board and senior management. Risk management staff should be separate from and independent of position-taking staff.

Institutions should have their measurement, monitoring and control functions reviewed on a regular basis by an independent party. It is essential that any independent reviewer ensures that the institution's risk measurement system is sufficient to capture all material elements of market risk, whether arising from on- or off-balance sheet activities.

Section 6 LINES OF RESPONSIBILITY AND AUTHORITY

Care should be taken to ensure that there is adequate separation of duties in key elements of the risk management process to avoid potential conflicts of interest.
Management should ensure that sufficient safeguards exist to minimize the potential that individuals initiating risk-taking positions may inappropriately influence key control functions of the risk management process such as the development and enforcement of policies and procedures, the reporting of risks to senior management, and the conduct of back-office functions.

The nature and scope of such safeguards should be in accordance with the size and structure of the institution. They should also be commensurate with the volume and complexity of market risk incurred by the institutions and the complexity of its transactions and commitments. Although the controls over market risk will vary among institutions depending on the nature and extent of their activities, the key elements of any control program are well-defined procedures governing:

1. organizational controls to ensure that there exists a clear and effective segregation of duties between those persons who initiate transactions and those who are responsible for operational functions such as arranging prompt and

accurate settlement, and timely exchanging and reconciliation of confirmations, or account for market activities;

2. procedural controls to ensure that:

   a. transactions are fully recorded in the records and accounts of the institution;

   b. transactions are correctly settled; and

   c. unauthorized dealing is promptly identified and reported to management;

3. controls to ensure that market activities are monitored frequently against the institution's market risk, counterparty and other limits and that excesses are reported; and

4. controls to ensure institution’s compliance with applicable laws and regulations.

Independent audits are a key element in managing and controlling an institution's market risk management program.

Each institution should use them to ensure compliance with, and the integrity of, the market risk policies and procedures. Independent audits should, over a reasonable period of time, test the institution's market risk management activities in order to:

   a. ensure market risk management policies and procedures are being adhered to;
   b. ensure management controls over market effective positions;

   c. verify the adequacy and accuracy of management information reports regarding the institution's market risk management activities;

d. ensure that personnel involved in market risk management are provided with accurate and complete information about the institution's market risk policies and risk limits and have the expertise required to make effective decisions consistent with the risk management policies.

Assessments of the market risk operations should be presented to the institution's board of directors for review on a timely basis. Identified material weaknesses should be given appropriate and timely high level attention and management's actions to address those weaknesses should be objectively verified and reviewed.

Section 1 INTRODUCTION

Globalization of financial services, together with increased financial innovation, are making the activities of institutions and their risk profiles (i.e. the level of risk across an institution's activities and/or risk categories) more complex.

Due to these developments, operational risk is becoming more pronounced. Examples of these developments include:

a The increased use of highly automated technology which has the potential to transform risks from manual processing errors to system failure risks, as greater reliance is placed on automated systems;

b Growth of e-banking brings with it potential risks (e.g. internal and external fraud and system security issues) that are not yet fully understood;

c. Acquisitions, mergers, and consolidations bringing the risk of system incompatibility and loss of staff morale;

d. Engagement in risk mitigation techniques (e.g. collateral and derivatives) by institutions to optimize their exposure to market risk and credit risk, but which in turn may produce other forms of risk (e.g. legal risk); and

e. Growing use of outsourcing arrangements and the participation in clearing and settlement systems, which can mitigate some risks but can also present other significant risks to institutions.

The diverse set of risks resulting from the above developments can be grouped under the heading of 'operational risk', which is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk is a term that has a variety of meanings within the banking industry. Whatever the exact definition, a clear understanding by institutions of what is meant by operational risk is critical to the effective management and control of this risk category.

It is also important that the definition considers the full range of material operational risks facing the institution and captures the most significant causes of severe operational losses. Operational risk may arise from a number of sources as follows:

1.1 People/Personnel

Events that may result into substantial loss include frauds like intentional misreporting of positions, employee theft, insider dealings, robbery, forgery, cheque kiting, and damage from computer hacking. Some of the contributing factors are as follows:

a. lack of adequate skills and knowledge;

b. inadequate training and development;

c. improperly aligned compensation schemes and incentives;

d. lack of understanding of performance standards or expectations; and

e. inadequate human resource control (including supervision and segregation of incompatible duties)

1.2 Internal processes and systems

Business disruption and system failures such as hardware and software failures, telecommunication problems, and utility outages, data entry errors, collateral management failures, unapproved access given to client accounts, non-client counterparty misperformance, and vendor disputes are examples of operational risk resulting from internal processes and systems.

Some of the contributing factors are as follows:

a. damage to physical assets;

b. inadequate or obsolete technology;

c. lack of proper documentation;

d. lack of or inadequate policies, procedures and controls;

e. Poor management information system; and

f. lack of or inadequate contingent plans.

1.3 External events

Terrorism, vandalism, earthquakes, fires and floods are examples of events that may cause operational risk in an institution.

It is clear that operational risk differs from other risks in that it is typically not directly taken in return for an expected reward, but exists in the natural course of corporate activity, and that this affects the risk management process.

At the same time, failure to properly manage operational risk can result in a misstatement of an institution's risk profile and expose the institution to significant losses.

Section 2 BOARD AND SENIOR MANAGEMENT OVERSIGHT

Failure to understand and manage operational risk, which is present in virtually all transactions and activities, may greatly increase the likelihood that some risks will go unrecognized and uncontrolled.

Board and senior management are responsible for creating an organizational culture that places high priority on effective operational risk management and adherence to sound operating controls. Operational risk management is most effective where an institution's culture emphasizes high standards of ethical behaviour at all levels of the institution. The board and senior management should promote an organizational culture, which establishes through both actions and words the expectations of integrity for all employees in conducting the business of the institution.

2.1 Board Oversight

Boards of directors have ultimate responsibility for the level of operational risk taken by their institutions.

The board of directors should approve the implementation of an institution-wide framework to explicitly manage operational risk as a distinct risk to the institution's safety and soundness. The board should provide senior management with clear guidance and direction regarding the principles underlying the framework and approve the corresponding policies developed by senior management.

An operational risk framework should be based on an appropriate definition of operational risk, which clearly articulates what constitutes operational risk in that institution.

The framework should cover the institution's tolerance for operational risk, as specified through the policies for managing this risk and the institution's prioritization of operational risk management activities, including the extent of, and manner in which, operational risk is transferred outside the institution.

It should also include policies outlining the institution's approach to identifying, assessing, monitoring and controlling/mitigating the risk.

The degree of formality and sophistication of the institution's operational risk management framework should be commensurate with the institution's risk profile.

The board is responsible for establishing a management structure capable of implementing the institution's operational risk management framework. Since a significant aspect of managing operational risk relates to the establishment of strong internal controls, it is particularly important that the board establishes clear lines of management responsibility, accountability and reporting. In addition, there should be separation of responsibilities and reporting lines between operational risk control functions, business lines and support functions in order to avoid conflict of interest. The framework should also articulate the key processes the institution needs to have in place to manage operational risk.

The board should review the framework regularly to ensure that the institution is managing the operational risks arising from external market changes and other environmental factors, as well as those operational risks associated with new products, activities or systems. This review process should also aim to assess industry best practice in operational risk management appropriate for the institution's activities, systems and processes.

If necessary, the board should ensure that the operational risk management framework is revised in light of this analysis, so that material operational risks are captured within the framework.

2.1 Senior Management Oversight

Management should translate the operational risk management framework established by the board of directors into specific policies, processes and procedures that can be implemented and verified within different business units.

Senior management should clearly assign authority, responsibility and reporting relationships to encourage and maintain this accountability and ensure that the necessary resources are available to manage operational risk effectively. Moreover, senior management should assess the appropriateness of the management oversight process in light of the risks inherent in a business unit's policy.

Senior management should ensure that institution activities are conducted by qualified staff with the necessary experience, technical capabilities and access to resources, and that staff responsible for monitoring and enforcing compliance with the institution's risk policy have authority and are independent from the units they oversee.

Management should ensure that the institution's operational risk management policy has been clearly communicated to staff at all levels in units that are exposed to material operational risks.

Senior management should also ensure that the institution's remuneration policies are consistent with its appetite for risk. Remuneration policies which reward staff that deviate from policies (e.g. by exceeding established limits) weaken the institution's risk management processes.

Particular attention should be given to the quality of documentation controls and to transaction-handling practices. Policies, processes and procedures related to advanced technologies supporting high transactions volumes, in particular, should be well documented and disseminated to all relevant personnel.

Section 3 STRATEGY, POLICIES, PROCEDURES AND LIMITS

The institution should put in place an operational risk management policy. The policy should, at minimum, include:

a. the strategy given by the board of the institution;

b. The systems and procedures to institute effective operational risk management framework; and

c. the structure of operational risk management function and the roles and responsibilities of individuals involved.

The policy should establish a process to ensure that any new or changed activity, such as new products or systems conversions, will be evaluated for operational risk prior to its implementation.

It should be approved by the board and documented. The management should ensure that it is communicated and understood throughout in the institution. The management also needs to place proper monitoring and control processes in order to have effective implementation of the policy.

The policy should be regularly reviewed and updated, to ensure it continues to reflect the environment within which the institution operates.

Institutions should also establish policies for managing the risks associated with outsourcing activities. Outsourcing of activities can reduce the institution's risk profile by transferring activities to others with greater expertise and scale to manage the risks associated with specialized business activities. However, an institution's use of third parties does not diminish the responsibility of the board of directors and management to ensure that the third-party activity is conducted in a safe and sound manner and in compliance with applicable laws.

Outsourcing arrangements should be based on robust contracts and/or service level agreements that ensure a clear allocation of responsibilities between external service providers and the outsourcing institution.

Furthermore, institutions need to manage residual risks associated with outsourcing arrangements, including disruption of services.

Business Continuity and Disaster Recovery Plan

For reasons that may be beyond an institution's control, a severe event may result in the inability of the institution to fulfill some or all of its business obligations, particularly where the institution's physical, telecommunication, or information technology infrastructures have been damaged or made inaccessible. This can, in turn, result in significant financial losses to the institution, as well as broader disruptions to the financial system through channels such as the payments system.

This requires that institutions establish disaster recovery and business continuity plans that take into account different types of plausible scenarios to which the institution may be vulnerable, commensurate with the size and complexity of the institution's operations.

Institutions should identify critical business processes, including those where there is dependence on external vendors or other third parties, for which rapid resumption of service would be most essential. For these processes, institutions should identify alternative mechanisms for resuming service in the event of an outage. Particular attention should be paid to the ability to restore electronic or physical records that are necessary for business resumption.

Where such records are backed-up at an off-site facility, or where an institution's operations must be relocated to a new site, care should be taken that these sites are at an adequate distance from the impacted operations to minimize the risk that both primary and back-up records and facilities will be unavailable simultaneously.

Institutions should periodically review their disaster recovery and business continuity plans so that they are consistent with their current operations and business strategies. Moreover, these plans should be tested periodically to ensure that the institution would be able to execute the plans in the unlikely event of a severe business disruption.

Section 4 RISK MEASUREMENT, MONITORING AND MANAGEMENT INFORMATION SYSTEMS

Risk identification is paramount for the subsequent development of a viable operational risk monitoring and control system.

Effective risk identification considers both internal factors (such as the institution's structure, the nature of the institution's activities, the quality of the institution's human resources, organizational changes and employee turnover) and external factors (such as changes in the industry and technological advances) that could adversely affect the achievement of the institution's objectives.

In addition to identifying the most potentially adverse risks, institutions should assess their vulnerability to these risks. Effective risk assessment allows the institution to better understand its risk profile and most effectively target risk management resources.

Amongst the possible tools that may be used by institutions for identifying and assessing operational risk are:

4.1 Self Risk Assessment

An institution should assesses its operations and activities against a menu of potential operational risk vulnerabilities. This process is internally driven and often incorporates checklists and/or workshops to identify the strengths and weaknesses of the operational risk environment.

4.2 Risk Mapping

In this process, various business units, organizational functions or process flows are mapped by risk type. This exercise can reveal areas of weakness and help prioritize subsequent management actions.

4.3 Risk Indicators

Risk indicators are statistics and/or metrics, often financial, which can provide insight into an institution's risk position.

These indicators are to be reviewed on a periodic basis (such as monthly or quarterly) to alert institutions to changes that may be indicative of risk concerns. Such indicators may include the number of failed trades, staff turnover rates and the frequency and/or severity of errors and omissions. Threshold/limits could be tied to these indicators such that when exceeded, could alert management on areas of potential problems.

4.4 Historical Risk Incidence Database

The use of data on an institution's historical loss experience could provide meaningful information for assessing the institution's exposure to operational risk and developing a policy to mitigate/control the risk.

An effective way of making good use of this information is to establish a framework for systematically tracking and recording the frequency, severity and other relevant information on individual loss events. Institutions may also combine internal loss data with external loss data (from other institutions), scenario analyses, and risk assessment factors.

Depending on the scale and nature of the activity, institutions should understand the potential impact on their operations and their customers of any potential deficiencies in services provided by vendors and other third-party or intra-group service providers, including both operational breakdowns and the potential business failure or default of the external parties.

The board and management should ensure that the expectations and obligations of each party are clearly defined, understood and enforceable. The extent of the external party's liability and financial ability to compensate the institution for errors, negligence, and other operational failures should be explicitly considered as part of the risk assessment. Institutions should carry out an initial due diligence test and monitor the activities of third party providers, especially those lacking experience of the banking industry's regulated environment, and review this process (including re-evaluations of due diligence) on a regular basis.

For critical activities, the institution may need to consider contingency plans, including the availability of alternative external parties and the costs and resources required to switch external parties, potentially on very short notice.

Control activities are designed to address the operational risks that an institution has identified. For all material operational risks that have been identified, the institution should decide whether to use appropriate procedures to control and/or mitigate the risks, or bear the risks.

For those risks that cannot be controlled, the institution should decide whether to accept these risks, reduce the level of business activity involved, or withdraw from this activity completely.

Some significant operational risks have low probabilities but potentially very large financial impact. Moreover, not all risk events can be controlled e.g. natural disasters.

Risk mitigation tools or programmes can be used to reduce the exposure to, or frequency and/or severity of such events. For example, insurance policies can be used to externalize the risk of "low frequency, high severity" losses which may occur as a result of events such as third-party claims resulting from errors and omissions, physical loss of securities, employee or third-party fraud, and natural disasters.

However, institutions should view risk mitigation tools as complementary to, rather than a replacement for, thorough internal operational risk control. Having mechanisms in place to quickly recognize and rectify legitimate operational risk errors can greatly reduce exposures. Careful consideration also needs to be given to the extent to which risk mitigation tools such as insurance truly reduce risk, or transfer the risk to another business sector or area, or even create a new risk e.g. legal or counterparty risk.

Investments in appropriate processing technology and information technology security are also important for risk mitigation.

However, institutions should be aware that increased automation could transform high-frequency, low-severity losses into low-frequency, high-severity losses. The latter may be associated with loss or extended disruption of services caused by internal factors or by factors beyond the institution's immediate control e.g. external events. Such problems may cause serious difficulties for institutions and could jeopardize an institution's ability to conduct key business activities. Institutions should therefore establish disaster recovery and business continuity plans that address this risk.

An effective monitoring process is essential for adequately managing operational risk. Regular monitoring activities can offer the advantage of quickly detecting and correcting deficiencies in the policies, processes and procedures for managing operational risk. Promptly detecting and addressing these deficiencies can substantially reduce the potential frequency and/or severity of a loss event.

In addition to monitoring operational loss events, institutions should identify appropriate indicators that provide early warning of an increased risk of future losses. Such indicators (often referred to as key risk indicators or early warning indicators) should be forward-looking and could reflect potential sources of operational risk such as rapid growth, the introduction of new products, employee turnover, transaction breaks, system downtime, and so on.

When thresholds are directly linked to these indicators an effective monitoring process can help identify key material risks in a transparent manner and enable the institution to act upon these risks appropriately.

The frequency of monitoring should reflect the risks involved and the frequency and nature of changes in the operating environment. Monitoring should be an integrated part of an institution’s activities. The results of these monitoring activities should be included in regular management and board reports, as should compliance reviews performed by the internal audit and risk management functions.

Senior management should receive regular reports from appropriate areas such as business units, the operational risk management office and internal audit. The operational risk reports should contain internal financial, operational, and compliance data, as well as external market information aboutevents and conditions that are relevant to decision making.

Reports should be distributed to appropriate levels of management and to areas of the institution on which concerns may have an impact. Reports should fully reflect any identified problem areas and should motivate timely corrective action on outstanding issues. To ensure the usefulness and reliability of these reports, management should regularly verify the timeliness, accuracy, and relevance of reporting systems and internal controls in general.

Management may also use reports prepared by external sources (auditors, supervisors) to assess the usefulness and reliability of internal reports. Reports should be analyzed with a view to improving existing risk management performance as well as developing new risk management policies, procedures and practices.

In general, the board of directors should receive sufficient higher-level information to enable them to understand the institution's overall operational risk profile and focus on the material and strategic implications for the business.

Section 5 INTERNAL CONTROLS / RISK REVIEWS

Internal control system should be established to ensure adequacy of the risk management framework and compliance with a documented set of internal policies concerning the risk management system. Principal elements of this could include, for example:

1. top-level reviews of the institution's progress towards the stated objectives;

2. checking for compliance with management controls;

3. policies, processes and procedures concerning the review,ctreatment and resolution of non-compliance issues; and

4. a system of documented approvals and authorizations to ensure accountability to the appropriate level of management.

Although a framework of formal, written policies and procedures is critical, it needs to be reinforced through a strong control culture that promotes sound risk management practices.

Board and senior management are responsible for establishing a strong internal control culture in which control activities are an integral part of the regular activities of an institution. Controls that are an integral part of the regular activities enable quick responses to changing conditions and avoid unnecessary costs.

Operational risk can be more pronounced where institutions engage in new activities or develop new products (particularly where these activities or products are not consistent with the institution's core business strategies), enter unfamiliar markets, and/or engage in businesses that are geographically distant from the head office. It is therefore important for institutions to ensure that special attention is paid to internal control activities including review of policies and procedures to incorporate such conditions.

Institutions should have in place adequate internal audit coverage to verify that operating policies and procedures have been implemented effectively. The board (either directly or indirectly through its audit committee) should ensure that the scope and frequency of the audit programme is appropriate to the risk exposures. Audit should periodically validate that the institution's operational risk management framework is being implemented effectively across the institution.

To the extent that the audit function is involved in oversight of the operational risk management framework, the board should ensure that the independence of the audit function is maintained.

This independence may be compromised if the audit function is directly involved in the operational risk management process. The audit function may provide valuable input to those responsible for operational risk management, but should not itself have direct operational risk management responsibilities.

An effective internal control system also requires existence of appropriate segregation of duties and that personnel are not assigned responsibilities which may create a conflict of interest. Assigning such conflicting duties to individuals, or a team, may enable them to conceal losses, errors or inappropriate actions.

Therefore, areas of potential conflict of interest should be identified, minimized, and subjected to careful independent monitoring and review.

In addition to segregation of duties, institutions should ensure that other internal practices are in place as appropriate to control operational risk. Examples of these include:

1. close monitoring of adherence to assigned risk limits or thresholds;

2. maintaining safeguards for access to, and use of, institution's assets and records;

3. ensuring that staff have appropriate expertise and training;

4. identifying business lines or products where returns appear to be out of line with reasonable expectations e.g. where a supposedly low risk, low margin trading activity generates high returns that could call into question whether such returns have been achieved as a result of an internal control breach; and

5. regular verification and reconciliation of transactions and accounts.

A. GENERAL POLICY AND CONTROL GUIDELINES:

1. All Department Heads must formulate, document and use the approved MEMO FORMAT and MANUAL FORMAT approved by the President. (See Exhibit "9.1A" to "9.1C")

2. CSB MEMO or CIRCULARS must be sequential indicating the issuing department, year, reference number and page number on a yearly basis. (See Exhibit "9.1C")

3. All Department Heads shall maintain and be accountable with their own Department Manual and Operations Manual.

4. Any changes in the Bank's Policies must <u>be discussed before the OPCOM</u>, formulated and to be documented (See Exhibit "9.1B") recommended by the Policy Owner, to be concurred by the concerned OPCOM members approved by the President and if necessary, confirmed by EXECOM or BOARD.

NOTE: The Compliance Department identifies if a policy has to be confirmed by EXECOM/BOARD.

NOTE: In any case, the Department Head may ask the Compliance Department if a policy has to be endorsed for Board Confirmation or approval although it was signed by the President. Policies shall not be binding unless it has an approval from the President.

5. The content of a propose Policy must at least have the following:

a. The Title of the Policy, stating the Purpose, policy owner, roles and functions;
b. Objectives and/or Definition of Terms as may be needed;
c. Policy Guidelines or General Policy as the case may be;
d. Procedural Guidelines or General Procedures as the case may be;
e. Annexes as may be needed;
f. Controls or Control Guidelines as may be required;
g. Exhibits (actual forms); and
h. Approval Sheet (if necessary), such as Sec. Cert./Confirmation Sheet etc…

NOTE: Annexes must be sequential such as "A", "B", "C" (or referred as scanned forms as may be needed) etc.. That will form part of the Policy while Exhibits (actual forms) may have a separate file inserted in the last page of each Manual accordingly tantamount to the numbering (for easy reference representing which Part or Section). For example Exhibit 1 for Part 1, and the exhibit shall be Exhibit "1.1" if more than one Exhibit "1.1A" and Exhibit "1.1B as the case may be".

6. In case there are any further comments, the concerned Department Head may prepare and attach their comments and suggestions to the policy duly signed.

7. The approved policies & procedures with an "Approval Sheet" signed by the President must be cascaded not later than three (3) banking days by the RECOMMENDING DEPARTMENT/UNIT Head and POLICY OWNER to all concerned Department/Units or employees of the Bank for implementation and compliance. Furthermore, Compliance Department notifies the RMD, QA, ISO and Department Heads on the approved policies and procedures via memorandum. (See Exhibit 9.1E)

8. Each department manual must be supported by a "VERSION CONTROL" for monitoring of changes such as amendment, revision, addendum or deletion. Old policy which has been amended, revised or pulled out must be placed at the back of the department manual for future reference and control purposes. (See Exhibit 9.1D)

9. Concerned Department Heads who propose for a new policy or change with regards to the policy concerning other policy of other Department or existing Policy of the Bank, may be allowed so long as it is justified, discussed, documented and approved by the approving authority such as the concerned OPCOM members, and the President.

10. Final approval of all policies such as amendments, revisions, addendum, deletion or full revision shall be endorsed thru Chief Compliance Officer (CCO) for President's approval.

11. The OPCOM Secretariat, who records the minutes during OPCOM meeting, shall furnish RMD-Operations Risk and other concerned Department/Unit Heads a copy of the minutes for monitoring purposes. Status of the new policies and procedures shall be discussed by the process owner during OPCOM.

12. Policies not ratified, disapproved, or cannot be implemented due to disputes, misunderstandings of policies shall be resolved through an "Ad Hoc" committee meeting to be set-up approved by the President.

13. For purposes of BSP examination, if requested by BSP examiner, all Departments, Unit Heads, or Office maintaining their own Department Manuals must be prepared, ready and keep available (Soft and Hard Copies) of their respective updated Department Manual.

    NOTE: Department Manuals must be treated as their own or covenant by its respective Department Head including their Officers and Staff with respect to their policies and procedures of the Bank for compliance.

14. A shadow copy of the "SECRETARY'S CERTIFICATE" accomplished by LSCAD pertaining to the Board/EXECOM approved Policies and Procedures or Manuals shall be forwarded to RMD for the issuance of Memo Circular to all concerned Department/Unit Heads, Office and Business Managers.

15. Once approved, the Compliance Department shall course thru Quality Assurance Unit or other Department other than the owner of the policy to do "Internal Policy Testing" not later than 30 days after the policy has been cascaded by the policy owner who shall monitor the policy. Therefore, the Compliance Department schedules the date of internal policy testing and determines if a new policy has to be tested for internal control purposes.

16. The purpose of the "revalida" or INTERNAL POLICY testing is to ensure that all policies and procedures are being cascaded by the Department Head to all employees of the Bank within their jurisdiction.

17. All Recommended policies by the Risk Management Department (RMD) approved by Risk Oversight Committee (ROC) must be incorporated and documented by the concerned Department Head in their respective Department Manual.

18. Compliance Department may invite the concerned Department Head for purposes of presentation to EXECOM/BOARD the new, revised or changes in Bank's policies and procedures.

19. Cascading and dissemination of the approved policies and procedures initiated by the Department Heads shall be performed as follows:
    a. Conduct a meeting to discuss how the new, amended, revised and approved policies and procedures are to be implemented.
    b. Disseminate the approved policies & procedures. (with hard copies or via intranet)
    c. Explain thoroughly the procedures, guidelines or mechanics about proper implementation of the approved Policies & Procedures.
    d. May provide seminars, training or workshop as may be needed to address and to discuss in details for proper implementation of the approved policies & procedures approved by the Management.
    e. Ensure that the approved policies & procedures are being strictly followed.
    f. Officers within their Department or the Policy Owner shall conduct strict monitoring to ensure that the approved policies & procedures are being followed accordingly.

20. All approved Department Manuals and Operations Manual aside from the Manuals maintained by respective Department Heads must be kept inside the vault or safe place after the Banking Hours. All Department Heads, Unit Heads or Office shall update, reconcile or submit a shadow copy of their approved and documented Policies to RMD once approved not later than two Banking Days for proper compilation (soft and hard copy/ies) for safekeeping inside the vault or in a safe place. (see number 14 of this Policy for clarification)

21. For control purposes, in the event of misunderstanding, disputes or misconception on the approved policies, the policies maintained by RMD-Operations Risk shall be followed. Therefore, All Department Heads shall submit their Policies and must be responsible to reconcile their Policy to be compiled by RMD-OPERATIONS RISK.

IMPORTANT

1. **Policy originates from the following sources:**
   a. **President's mandate**
   b. **Risk Oversight Committee;**
   c. **Compliance Department - Regulatory Policies such as BSP circulars and SEC;**
   d. **Department Heads or Other concerned Department Heads initiation.**

2. **The Compliance Department conducts compliance testing based on regulations of BSP and SEC.**

3. **The Internal Audit's, Compliance, Quality Assurance, and Risk Management Department's functions are to examine if policies and procedures were performed by employees.**

4. **All Departments, Units or Office are accountable and shall maintain their own Manuals, SPU is merely a repository and for control purposes of the Manuals, Operations Manuals including Department Manuals of Citystate Savings Bank for safekeeping purposes.**

5. **Second Line of Defense (i.e. QAU, RMD, and ISO) shall do the Internal Policy Testing as may be required by the Bank. The result of Internal Policy Testing shall be incorporated in employee's performance appraisal/File 201.**

6. **If in any case, a dispute of the policy arising from misunderstanding, clarification and for proper implementation, an "AD HOC" committee meeting shall be set up for a meeting to be resolved immediately.**

Activity	Timeline
1. Origination of Policy -Concerned Department Heads (RESEARCH, COMMENTS, ETC.)	5 working days
2. OPCOM DISCUSSION AND FINAL PROPOSAL APPROVAL	1 Day
3. ADHOC (OPTIONAL)	5 Days
4. EXECOM Confirmation (with date of Implementation)	5 Days
5. TOTAL DAYS FOR A POLICY TO BE APPROVED BY EXECOM (without ADHOC)	11 Working Days
6. TOTAL DAYS FOR A POLICY TO BE APPROVED BY EXECOM (with ADHOC)	16 Days Maximum
7. Internal Testing (To be Scheduled by Compliance Department)	2 Weeks after Date of Implementation
8. Board Approval	Once a month, every last Tuesday of the Month

ANNEX I

I. INTRODUCTION

This Charter is established by the Board of Directors of Citystate Savings Bank, Inc. The purpose of this Charter is to clearly define the Corporate Governance Committee's qualifications, authority and its duties and responsibilities. The CG Committee shall assist the Board of Directors in fulfilling its corporate governance responsibilities and in providing oversight in the implementation of the Bank's Compliance System through the Compliance Office.

II. ORGANIZATION and QUALIFICATIONS

The Members of the Committee shall be appointed annually by the Board and may be replaced or removed at any time by the Board of Directors.

The Committee shall be comprised of not less than three (3) members of the Board and shall include at least two (2) independent directors, including the chairperson. Members are defined as follows:

- is not an officer or employee of CSBI or its affiliates;
- is not a relative of an officer or other employees of CSBI or its affiliates;
- does not hold or control, or has not held or controlled, directly or indirectly, within the preceding year, assets representing 10 percent or more of any outstanding class of voting securities of CSBI; and
- does not have any outstanding extensions of credit from CSBI or its affiliates.

All members of the Committee shall have adequate understanding at least or competence at most, of CSBI's operations and environment.

III. MEETING

The Committee shall meet at least two times annually, or whenever necessary, at such times, as the Chair of the Committee shall designate. The Committee shall fix its own rules of procedure, and all Committee members are expected to attend each regular meeting. The majority of the members of the Committee shall constitute a quorum.

It is the responsibility of the Chairman to schedule and preside all meetings of the Committee. The agenda for Committee meetings will be prepared in consultation between the Committee Chairman (with input from the Committee members) and the Compliance Officer.

IV. DUTIES AND RESPONSIBILITIES

In discharging its responsibilities to review, authorize and approve director nominations, and corporate governance, the Committee shall:

(a) recommend to the Board of Directors the director nominees for election by the Bank's shareholders, including those nominees that are recommended by shareholders in accordance with the procedures set forth in the Bank's By-Laws

(b) recommend to the Board of Directors persons to fill vacancies on the Board of Directors

(c) recommend to the Board of Directors committee appointments, removal of Directors from committees or from the Board of Directors, rotation of committee members and Chairs and committee structure and operation

(d) recommend to the Board of Directors changes in the Bank's corporate governance policies and procedures, including changes to the Manual of Corporate Governance

(e) monitor compliance with the Manual on Corporate Governance

(f) annually review and update if necessary this charter for consideration by the Board of Directors

(g) report the matters considered and actions taken by the Corporate Governance Committee to the Board of Directors

(h) oversee the annual evaluation of the Board and its committees

(i) it shall oversee the implementation of the Bank's Compliance Program and the performance of Compliance Office, as follows:

i. review, at least annually, the Bank Compliance Program in accordance with existing regulatory requirements;

ii. monitor the implementation of the Bank's Compliance Program and ensure that compliance issues are resolved expeditiously;

iii. monitor the Bank's compliance with the applicable laws, regulations and rules of regulatory agencies and recommend to the Board appropriate actions based on the review of the reports submitted to/by Compliance Office; and

iv. review the regular reports submitted by Compliance Office as well as reports on significant issues, general status of Bank's level of compliance, relevant regulations, updates and other compliance matters.

ANNEX J

Section 1 PURPOSE

The Risk Oversight Committee (the "ROC" or "Committee") of Citystate Savings Bank, Inc. (the "CSBI" or "Bank") is a standing committee of the Board of Directors ("Board").

The purpose of the Committee is to assist the Board in fulfilling its responsibility with respect to:

1.1 the Citystate Savings Bank, Inc. (CSBI)'s risk governance structure,

1.2 the Bank's risk management guidelines and policies regarding credit, liquidity, market, operational and other related risk as necessary to fulfil the Committee's duties and responsibilities,

1.2 the Bank's risk tolerance

1.3 the Bank's capital, liquidity and funding, and

1.4 the performance of Bank's Chief Risk Officer

The Committee reports to the Board of Directors regarding Bank's risk profile, as well as its risk management framework, including the significant policies and practices employed to manage risks in CSBI's businesses, as well as the overall adequacy of the risk management function.

The Committee's role is one of oversight, recognizing that Senior Management is responsible for executing the bank's risk management. While the Committee has the responsibilities and powers set forth in this Charter, Senior Management is responsible for designing, implementing and maintaining an effective risk program. In this regard, the Bank's department heads or line managers are responsible for managing risks in the areas for which they are responsible.

Finally, the Bank's Chief Risk Officer ("CRO") manages the Bank's risk management guidelines and policies regarding credit, liquidity, market, operational and other related risk on a consolidated basis under CSBI's risk management framework.

The CRO also provide overall leadership for CSBI's risk management framework, independent risk management function and risk governance processes, including risk identification, measurement, monitoring and mitigation (i.e., I'M^3 Risk Framework)

Section 2 MEMBERSHIP

2.1 The Committee shall be represented by at least three (3) Board members appointed by the Board of Directors after considering the recommendation of the Nominating and Governance Committee or until their successors shall be duly qualified and appointed.

2.2 One of the Board members in the Committee should be an independent director who has no material relationship to the Bank – or its subsidiaries or affiliates – that may interfere with the exercise of his/her independence from management and the Bank or shall otherwise compromise the independence requirements of the regulatory authorities.

2.3 The Board shall designate one Committee member as the Committee's chair (the "Chairman").

2.4 The Board may also appoint any Senior Management Officers as *ex officio* or non-voting member of the Committee.

Section 3 OPERATIONS

3.1 The Committee shall hold regular meetings at least four times per year and report to the Board on a regular basis.

3.2 Meetings shall include any participants the Committee deems appropriate and shall be of sufficient duration and scheduled at such times as the Committee deems appropriate to discharge properly its responsibilities.

3.3 The Committee shall meet, as deemed necessary and appropriate, with the Chief Risk Officer and other Senior Management officers of the Bank, in separate executive sessions.

3.4 The Committee may form and delegate to one or more subcommittees all or any portion of the Committee's authority, duties and responsibilities, and may establish such rules as it determines necessary or appropriate to conduct the Committee's business.

3.5 The Committee shall have direct access to, and complete and open communication with, the Bank's Senior Management, including the Chief Risk Officer and other employees of the Risk Department, and may obtain advice and assistance from internal legal or other advisors.

3.6 The Bank shall provide for appropriate funding, as determined by the Committee, for the payment of:

a. ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties and responsibilities, and

b. compensation to independent legal or other advisors retained by the Committee.

3.7 The Committee shall review and assess annually its performance and report the results to the Board.

3.8 The Committee shall review and assess annually the adequacy of this charter and, if appropriate, recommend changes to this charter to the Board of Directors for approval.

Section 4 OVERSIGHT FUNCTIONS

Oversight of Risk Management

4.1 Review or discuss, as and when appropriate, with Senior Management, the Bank's risk governance structure and the Bank's risk management, guidelines and policies regarding credit, liquidity, market, operational and other related risk and the Bank's risk tolerance.

4.2 Review periodically the major risk exposures of the Bank and its business units, including credit, liquidity, market, operational and other related risk, against established risk measurement methodologies and the steps management has taken to monitor and control such exposures.

4.3 Receive, as and when appropriate, reports and recommendations from the Head of the Internal Audit Department (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) regarding the results of risk management reviews and assessments.

Oversight of Risk Tolerance

4.4 Oversee the Bank's process and policies for determining risk tolerance and review management's measurement of overall risk tolerance to established levels. As appropriate, confirm risk tolerance levels and capital targets and limits.

4.5 Receive, as and when appropriate, reports and recommendations from the Senior Management (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) on risk tolerance.

Oversight of Capital, Liquidity and Funding

4.6 Review periodically the steps the Bank management has taken to manage capital, liquidity and funding.

4.7 Receive, as and when appropriate, reports and recommendations from the Head of the Treasury Department (and other internal departments as necessary to fulfil the Committee's duties and responsibilities) on capital, liquidity and funding risk guidelines and policies.

Oversight of the Chief Risk Officer

4.8 Approve the appointment and, when and if appropriate, replacement of the Chief Risk Officer, who shall report directly to the Committee as well as to the Chief Executive Officer.

4.9 Review and evaluate periodically the qualifications and performance of the Chief Risk Officer.

Coordination with Other Board Committees and Senior Management

4.10 Coordinate with the Audit Committee and Operations Committee to help ensure that the Committee have received the information necessary to permit them to fulfil their duties and responsibilities with respect to oversight of risk management and risk assessment guidelines and policies.

4.11 Coordinate with the Compensation and/or Personnel Committee in relation to that Committee's role with respect to risk matters related to compensation.

Other Functions

4.12 Make such recommendations with respect to any of the above and other matters as the Committee deems necessary or appropriate.

4.13 Have such other authority, duties and responsibilities as may be delegated to the Committee by the Board.

Section 5 CORE RESPONSIBILITIES

(Per BSP Circular No. 749, Series of 2012 – "Guidelines in Strengthening Corporate Governance in BSP supervised FIs"

5.1 *Identify and evaluate exposures*

The Committee shall assess the probability of each risk becoming reality and shall estimate its possible effect and cost. Priority areas of concern are those risks that are most likely to occur and are costly when they happen.

5.2 *Develop risk management strategies*

The Committee shall develop a written plan defining the strategies for managing and controlling major risks. It shall identify practical strategies to reduce the chance of harm and failure or minimize losses if the risk becomes real.

5.3 *Oversee the implementation of the risk management plan*

The Committee shall conduct regular discussion on the institution's current risk exposure based on regular management reports and assess how the concerned units or offices reduced these risks.

5.4 *Review and revise the plan as needed*

The Committee shall evaluate the risk management plan to ensure its continued relevance, comprehensiveness, and effectiveness.

It shall revisit strategies, look for emerging or changing exposures, and stay abreast of developments that affect the likelihood of harm or loss.

The Committee shall report regularly to the Board of Directors the Bank's overall risk exposure, actions taken to reduce the risks, and recommend further actions or plans as necessary.