



ECONOMIC DEVELOPMENT BANK
FOR PUERTO RICO
Government of Puerto Rico

ASSET LIABILITY MANAGEMENT ADMINISTRATIVE POLICY

Approved by the Board of Directors of the
Economic Development Bank for Puerto Rico
June 28, 2000

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Part one

INTRODUCTION

Article 1 Title; Authority

This policy shall be known as the "Asset/Liability Management Policy" of the Economic Development Bank for Puerto Rico (EDB).

The Board of Directors of EDB adopts this policy pursuant to Article 5 of Law No. 22 of July 24, 1985, as amended, known as the "Law for the Economic Development Bank for Puerto Rico" (*the Act*).

Article 2 Purpose of this Policy

The purpose of this policy is to establish the procedures, standards and criteria for the management of EDB's balance sheet, including the management of interest rate risk and repricing opportunities and the term to maturity of EDB's assets and liabilities.

Article 3 Appointment of Committee; Members

The affairs relating to the management and administration of the assets and liabilities of EDB shall be under the direction of the Asset and Liabilities Committee of EDB ("ALCO" or the "Committee"). The committee shall consist of three members of the Board of Directors of EDB, to be appointed by the Board of Directors of EDB and the following officers of EDB: the President, all the Executive Vice Presidents, the Comptroller and the Treasurer. The Executive Vice President of Finance will serve as Committee Chairperson. The President of EDB will serve as Sub-Chairperson of the Committee and will preside the meetings if the Executive Vice President of Finance is absent for any reason. Each member of the Committee shall hold office until his/her successors shall be duly elected or appointed and qualified or until his/her death, resignation or removal from office.

Article 4 Quorum

Five members, one of whom shall be a member of the Board of Directors of EDB, shall constitute a quorum for the transaction of business at any meeting of ALCO.

Article 5 Meetings

The Committee will meet at least quarterly. The Committee may hold additional meetings during periods of increased economic activity and when specific issues require immediate attention. Special meetings of ALCO may be called at any time by or at the request of the Chairperson of the Committee or the President of EDB. ALCO may authorize variations and waivers from the policies then in effect, with such variation or waiver being promptly reported to the Board of Directors of EDB. Any such variations or waivers shall be documented in the minutes of ALCO. The minutes of ALCO shall be submitted periodically to the Board of Directors of EDB for their review as required under the Article 16 below.

Article 6 Responsibilities

ALCO will have the responsibility of establishing the policies and criteria for managing the size and components of the balance sheet of EDB with the objective of maximizing net income for EDB. The policies and criteria adopted by the Committee shall be appropriate for a governmental instrumentality of the Government of Puerto Rico. ALCO's duties and responsibilities shall include but not be limited to the following:

1. Develop an Asset/Liability Management Policy Statement for EDB.
2. Review at least on an annual basis, and to the extent deemed appropriate, existing policies, standards and criteria adopted by ALCO for EDB pursuant to this Policy.
3. Develop an asset/liability management review procedure for EDB including the implementation of monitoring and reporting systems to determine compliance with the policies adopted by ALCO.
4. Establish financial performance objectives for EDB.
5. Supervision of a management information system that supplies, on a timely basis, the information and data necessary for ALCO to fulfill its role as a business planner and asset/liability manager.
6. Approval of minutes of prior meeting.
7. Measure performance based on the standards and criteria adopted from time to time by ALCO to accomplish the objective of this Policy.

8. Review periodically the outlook for interest rates and the economy at the local, national and international levels.
9. Review periodic reports that reflect the impact on earnings, capital and asset values of changes in interest rates and the mix of assets and liabilities of EDB.
10. Review the present and determine the future liquidity position that should be adopted by EDB.
11. Review parameters of pricing, volume and maturity of deposits, loans and investments of EDB.
12. Review at least annually the strategic and long-term financial goals and objectives of EDB.

Article 7 Objectives and Goals

The objective of the ALCO shall be to maximize net interest income for EDB within the constraints of prudent capital adequacy, liquidity and safety both on a short and long-term basis. The policies adopted by ALCO shall be taken into account by EDB to determine loan pricing policies, venture capital structuring policies, deposit interest rate policies, asset mix, investment portfolio and volume guidelines, liquidity and capital planning. The general goals of the policies adopted by ALCO are to:

1. Focus attention on the volume/mix, repricing opportunities, products pricing, and maturities of assets and liabilities of EDB.
2. Create the procedures for integrated balance sheet management and to maintain liquidity.
3. Minimize exposure to changes in interest rates to provide optimum and stable net interest margin.
4. Reduce, to the extent possible, the difference between rate-sensitive assets and liabilities.
5. Maintain an investment portfolio that provides liquidity to satisfy the cash requirements of EDB and maximizes the potential for profit of these assets.
6. Maintain an adequate level of capitalization.

Part two

FINANCIAL PERFORMANCE

Article 8 Objectives

It is ALCO's responsibility to establish goals related to financial performance objectives for the current fiscal year and the next three fiscal years (medium term). The Committee shall adopt minimum standards or benchmarks which must be reviewed periodically and, if deemed appropriate by ALCO, must be revised at the first ALCO meeting that is held during each fiscal year of EDB.

Profitability Ratios
Return on Assets
Return on Capital
Net Interest Margin as a Percentage of Earnings on Assets
Non-interest Expense to Earning Assets.
Net Operating Income to Earning Assets
Efficiency Ratio
Capitalization Ratios
Earning Assets to Total Assets
Net Loans to Earning Assets
Loan Loss Allowance to Non Current Loans
Reserve for Loan Losses to Loans
Net Loans to Deposits

These objectives are interrelated and therefore must be viewed as interdependent components of EDB's overall financial performance.

Article 9 Definitions

1) Return on assets (ROA)	Net income after extraordinary items (annualized) as a percent of average total assets.
2) Return on capital	Annualized net income as a percent of average capital on a consolidated basis. Note: If retained earnings are negative, the ratio is shown as N/A.
3) Net interest margin	Net interest income (net of provision for loan) (annualized) as a percent of average net earning assets.
4) Non interest expense to earning assets	Salaries and employee benefits, expenses of premises and fixed assets, and other non-interest expenses (annualized) as a percent of average earning assets.
5) Net operating income to assets	Net operating income (annualized) as a percent of average assets.
6) Efficiency ratio	Non-interest expense, less the amortization expense of intangible assets, as a percent of the sum of net interest income and non-interest income.
7) Earning assets to total assets	Average earning assets to average total assets.
8) Net loans to earning assets	Loans receivables, net of unearned income, allowances and reserves as a percent of earning assets.
9) Loan loss allowance to non-current loans	Allowance for loan losses as a percent of non-current loans.
10) Reserves for loan losses to loans	Reserves for loan losses to loans.
11) Net loans to deposits	Loans financing receivable net of unearned income, allowances and reserves as a percent of total deposits.

Part three

MANAGEMENT OF FUNDS

Article 10 Liquidity and Management of Funds

EDB should be in position to meet its loan commitments to its customers. Accordingly, EDB shall measure its liquidity based on its ability to raise cash at a reasonable cost when needed. Potential liquidity demands may include funding loan commitments, cash withdrawals and other funding needs.

In addition to the liquidity provided by balance sheet cash flow, EDB may supplement liquidity with other external sources of capital such as lines of credit with other banks and repurchase agreement with brokers - dealers. Lines of credit, however, shall be utilized by EDB only to satisfy short-term demands for cash. ALCO will ensure that EDB has sufficient liquidity in order to satisfy unanticipated cash requirements.

Article 11 Liquidity

EDB's liquidity shall be determined based on a static analysis of the relationship between liquid assets and short-term liabilities, [which are vulnerable to non-replacement under abnormally stringent conditions]. This test is called the Basis Surplus/(Deficit).

If the calculation produces a positive net number (BASIC SURPLUS), this means, by definition, that since all of the short-term liabilities have been allocated to the support of the liquid assets positions, then none of the non-liquid assets in the balance sheet can be deemed to be supported by vulnerable liabilities. However, if a BASIC DEFICIT (negative number) is produced, then the result of the calculation represents the extent by which longer-term, non-liquid assets are being supported by vulnerable liabilities.

BASIC SURPLUS (DEFICIT)	
<u>Liquid assets:</u>	
Cash & due from banks	\$
CD's & Commercial paper	
Securities purchased under agreement to resell	
U.S. Government backed securities (at BV):	
Agency notes (due in one year or less)	#
Agency notes (due over one year)	#
Mortgage backed securities (at BV):	
CMO's	
Other marketable assets (at BV):	
Asset backed securities	#
Note receivable - CDE	#
Other marketable assets	#
Less: Liabilities secured by any of the assets above (936 Notes)	
Total liquid assets	
Available/unused lines of credit	
Total liquid assets & available/unused lines of credit	
<u>Short term liabilities</u>	
Time deposits	
Securities sold under agreement to repurchase	
Other volatile liabilities	
Total short term liabilities	
Basic surplus (deficit)	
Liquidity ratio	

ALCO shall adopt policies that, to the extent possible, avoid unnecessary expense/opportunity loss(es) that result from EDB having excess liquidity. Said policies shall consider the forecast of future disbursement of loans and capital investments. ALCO shall adopt a position regarding the expected core funding for each fiscal year. This calculation shall be made by EDB, at least, on a quarterly basis and shall be reviewed by ALCO at each of these meetings.

Part four

INTEREST RATE RISK MANAGEMENT

Article 12 Interest Rate Risk Management

Interest rate risk is the exposure of EDB's earnings and capital to interest rate changes and fluctuations. EDB should adopt policies that, to the extent possible, reduce risk on its earnings and capital due to interest rate changes and/or fluctuations. Subject to this limitation, EDB may assume such interest rate risk as a prudent investor would assume in order to maximize the potential for profits by EDB.

It is acknowledged that EDB is in the business of taking both credit and interest rate risk. To the extent that credit risk is minimized, EDB shall have the capacity to assume greater interest rate risk and vice-versa. It is also acknowledged that as exposure to interest rate risk is reduced, net interest margin will also be reduced.

Article 13 Managing One Year Horizon

ALCO will be responsible for adopting short-term interest rate risk management strategies and policies for EDB in order to reduce interest rate risk exposure.

The strategies adopted by ALCO to manage interest rate risk may permit the acquisition of assets and liabilities of appropriate maturities in the cash market and may also permit off-balance sheet alternatives; provided, however, that any off-balance sheet alternative adopted by ALCO shall be subject to the prior written approval of the Board of Directors of EDB.

Since the impact of interest rate changes due to mismatched balance sheet positions in the one-year horizon can quickly and materially affect the income statement for the current fiscal year, the Committee, through the adoption of appropriate procedures, shall review the policies and strategies adopted by ALCO to manage interest rate risk periodically.

Article 14 Managing Long-term Sector

In addition, ALCO shall be responsible for adopting policies for the management of the long-term maturity/repricing sectors of the balance sheet of EDB. ALCO's functions and responsibilities in this area shall include:

1. Monitoring available opportunities and institute corrective actions (in the nature and mix of assets and liabilities) to address structural mismatches.
2. Review the appropriateness of fixed rate vs. adjustable rate lending and the formulation of policies to determine the pricing for loans to be made by EDB.
3. Review parameters for the investment portfolio in the context of overall balance sheet management (liquidity, credit risk, and earnings).

Article 15 Reporting

ALCO shall submit a semi-annual report to the Board of Directors regarding the implementation of these policies and the results. The reports submitted to the Board of Directors should include, but not be limited to, copies of the minutes of ALCO meetings and a financial package.

Part five
OTHERS

Article 16 Amendments

This document can be amended in a meeting of the Board of Directors duly called for that purpose and with the affirmative vote of a majority of the Directors of EDB.

Article 17 Effectiveness

This document shall take effect immediately after its approval by the Board of Directors of the Economic Development Bank for Puerto Rico.

Article 18 Severability Clauses

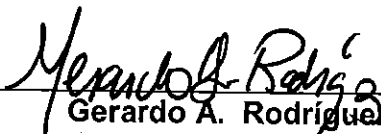
In the event any court of competent jurisdiction shall hold any provision of this Policy illegal or unenforceable, the judgment of such court shall not affect or render unenforceable any other provision of this Policy.

Article 19 Inconsistencies between the Act and this Policy


In the event of inconsistencies between the provisions of this Policy and the provisions of the Act, the provision of the Act shall prevail.

Article 20 Recommendations

The Executive Vice President of Finance and the President of the Economic Development Bank for Puerto Rico have recommended this Asset Liability Management Administrative Policy.



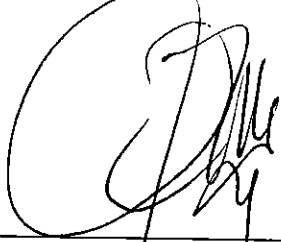
Gerardo A. Rodríguez
Executive Vice President
Economic Development Bank for
Puerto Rico



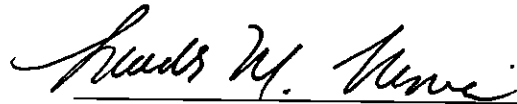
Agnes B. Suárez
President
Economic Development Bank for
Puerto Rico

Article 21 Approvals

The Board of Directors of the Economic Development Bank for Puerto Rico has approved the Asset Liability Management Administrative Policy this day of June 28, 2000.



Ismael E. Jusino
Secretary of the
Board of Directors of the
Economic Development Bank for
Puerto Rico



Lourdes M. Rovira
President
Board of Directors of
Economic Development Bank for
Puerto Rico