

Building a Safe and Resilient Cooperative System Aligned with Global Best Practices

DISCLAIMER

The Financial Oversight and Management Board for Puerto Rico (the “FOMB,” or “Oversight Board”) has formulated this Fiscal Plan based on, among other things, information obtained from the Public Corporation for Supervision and Insurance of Cooperatives of Puerto Rico (“COSSEC,” or the “Corporation”).

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This 2022 COSSEC Fiscal Plan is directed to the Governor and Legislature of Puerto Rico based on underlying data obtained from COSSEC. No representations or warranties, express or implied, are made by the Oversight Board with respect to such information.

This 2022 COSSEC Fiscal Plan is based on what the Oversight Board believes is the best information currently available to it. To the extent the Oversight Board becomes aware of additional information after it certifies this 2022 COSSEC Fiscal Plan that the Oversight Board determines warrants a revision of this 2022 COSSEC Fiscal Plan, the Oversight Board will so revise it.

For the avoidance of doubt, the Oversight Board does not consider and has not considered anything in the 2022 COSSEC Fiscal Plan as a “recommendation” pursuant to Section 205(a). Nevertheless, to the extent that anything in the 2022 COSSEC Fiscal Plan is ever deemed by a court to be a “recommendation” pursuant to Section 205(a), the Oversight Board hereby adopts it in the 2022 COSSEC Fiscal Plan pursuant to various provisions of Section 201(b). Under section 5(b) of Act 2-2017, the Puerto Rico Fiscal Agency, and Financial Advisory Authority (“AAFAF”, for its Spanish acronym) has the authority of supervising, executing, and administering the Fiscal Plan approved and certified in accordance with PROMESA and ensure that all covered entities of the Government of Puerto Rico, such as COSSEC comply with the approved Fiscal Plan.

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List of Acronyms and Key Terms

AA	Considered to be a high grade assigned to an issuer's bond by any of the major credit rating agencies (but not as high as AAA)
AAA	Highest possible rating that may be assigned to an issuer's bonds by any of the major credit rating agencies
AAFAF	The Puerto Rico Fiscal Agency and Financial Advisory Authority, by its Spanish acronym
ALLL	Allowance for loan and lease losses
BBB+	A BBB is a grade assigned to an issuer's bond by any of the major credit rating agencies; a BBB+ rating reflects an opinion that the issuer has the current capacity to meet its debt obligations but faces more solvency risk than an A-rated issue and less than a BB-rated issue if business, financial, or economic conditions change measurably
BCPR	Banco Cooperativo de Puerto Rico
BCBS	Basel Committee on Banking Supervision
BOD	Board of Directors
CAEL	Capital adequacy, Asset quality, Earnings, liquidity and Sensitivity
CAGR	Compound Annual Growth Rate
CAMEL	Capital adequacy, Asset quality, Management, Earnings, liquidity and Sensitivity
CARES Act	The Coronavirus Aid, Relief, and Economic Security Act
CDC	Cooperative Development Commission
CD	Certificates of Deposit
CECL	Current Expected Credit Loss
CMOS	Collateral Mortgage Obligation
COSSEC	Public Corporation for Supervision and Insurance of Cooperatives, by its Spanish acronym
COSVI	Life Insurance Cooperative of Puerto Rico
COVID-19	Coronavirus pandemic
FDIC	Federal Deposit Insurance Corporation

FICO® Score	Index for measuring consumer credit risk introduced by the Fair Isaac Corporation
FOMB	The Financial Oversight Management Board
FROB	Fund for Orderly Bank Restructuring, by its Spanish acronym
GAAP	Generally Acceptable Accounting Principles
GSEs	Government Sponsored Enterprises
KPI	Key Performance Indicators
LCPR	Liga de Cooperativas de Puerto Rico
MBS	Mortgage Backed Securities
MMDA	Money Market Deposit Accounts
NCUA	National Credit Union Administration
OE	Executive Order issued by The Government, by its Spanish acronym
OCIF	Office of the Commissioner of Financial Institutions by its Spanish acronym
OREO	Other Real Estate Owned
P&A	Purchase and Assumption
PROMESA	Puerto Rico Oversight, Management, and Economic Stability Act
PROSAD- COOP	Savings and Credit Cooperative Shares and Deposits Insurance Corporation
RAP	Regulatory Accounting Principles
ROA	Return on Assets
RTC	Resolution Trust Corporation
S&L	Savings and Loans associations, also known as “thrifts”
TDR	Troubled Debt Restructured
TMO	Transformation Management Office

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Executive Summary

The cooperative system is an important part of the financial infrastructure of Puerto Rico. It provides residents in communities across Puerto Rico with access to financial services. The cooperative system and COSSEC, as its regulator and insurer, have fulfilled this role for many years. However, there are several risks that could continue to undermine the full potential of the cooperative system if they are not promptly addressed. These risks are well known and have been publicly reported. The cooperative system must improve its long-term resilience by moving toward higher national standards for governance and transparent accounting. Near-term reforms can serve to maintain the safety and soundness of COSSEC’s insurance fund and the cooperative system as a whole. The objectives of the Oversight Board with respect to the COSSEC Fiscal Plan are to protect COSSEC’s Insurance Fund and depositors, build a safe and resilient cooperative system aligned with global regulatory best practices, e.g., those employed by U.S. federal regulators such as the National Credit Union Administration (“NCUA”) and the Federal Deposit Insurance Corporation (“FDIC”), and protect the approximately 1 million residents of Puerto Rico who depend on cooperatives for access to financial services.

The 2022 COSSEC Fiscal Plan outlines a comprehensive set of short-, medium-, and long-term measures that, when implemented by the Government and COSSEC in a timely manner, will pave the way towards a healthier, more sustainable cooperative system in the Commonwealth based on global best practices. The measures in this Fiscal Plan have been built around three main axes of reform for financial systems: implementing changes in governance; increasing transparency in accounting; and, improving supervisory interventions. Short- and mid-term measures include, but are not limited to, a new Board governance structure for COSSEC, a concrete timeline to transition from RAP to GAAP¹ accounting, and specific supervisory interventions needed to ensure timely interventions for failing cooperatives.

Moreover, this plan provides an overview of longer-term reforms that COSSEC must adopt to ensure the cooperative system can thrive into the future. The financial services industry is undergoing significant transformation as consumer expectations for the level of service provided have grown. For the cooperative system to thrive in the decades to come, bold steps will be needed to modernize and adopt forward-leaning digital capabilities to close the gap and effectively compete with federal credit unions and commercial banks operating in the local financial market.

While this 2022 COSSEC Fiscal Plan outlines the key measures needed to improve COSSEC’s ability to regulate the system, it will be effective only if COSSEC substantially steps up the scale and pace of its own transformation. COSSEC has commenced to implement certain measures that

¹ Regulatory accounting principles (RAP) and Generally Accepted Accounting Principles (GAAP). RAP is the applicable standard for cooperatives in Puerto Rico, while GAAP is the federal standard for financial institutions, including commercial banks and federal credit unions in Puerto Rico.

have been required under the certified Fiscal Plans of 2020 and 2021 (respectively “2020 CCFP” and “2021 CCFP” and jointly referred to as the “CCFPs”), including improving supervisory interventions of insolvent cooperatives, deepening engagement with cooperatives’ stakeholders, more proactively monitoring the systemic risk in the cooperative system by promoting routine exchange of reports and financial metrics, and improving the management of COSSEC’s budget. However, there is still work to be done towards building a safe and resilient cooperative system aligned with global best practices, and the Oversight Board still sees areas of concern, including COSSEC’s choice of requiring a capitalization plan from already insolvent cooperatives instead of directly moving forward with adequate measures to address their unrecoverable accumulated losses.

Further delays to the CCFPs’ milestones will only exacerbate the risks to the cooperative system. Accordingly, the 2022 COSSEC Fiscal Plan (“2022 CCFP”) includes much more detail on the actions, timelines, and milestones required to intervene in and implement final resolution for any insolvent cooperatives. The Fiscal Plan also includes budget incentives to allow COSSEC to build its professional staff subject to completion of the milestones.

A well-governed regulator and a well-capitalized insurance fund are critical to maintaining depositor confidence, particularly in times of uncertainty and crisis. Thoughtful actions now can set the stage for a more resilient and vibrant cooperative sector serving communities across Puerto Rico for years to come. COSSEC, as the insurer and regulator of the cooperative system, must comply with the Fiscal Plan pursuant to the Puerto Rico Oversight, Management, and Economic Stability Act of 2016.

Part I: Context for COSSEC and current challenges for the cooperative system

Chapter 1. Introduction and background

History and Context

The first manifestation of the cooperative system in Puerto Rico began in the late 1800s with “Los Amigos del Bien Público” (Friends of the Public Good), an organization that provided health services with fees that varied according to the beneficiary’s age. After the Spanish-American war, cooperatives started to gain traction, ultimately resulting in the first cooperative law being passed in 1920. In the 1940s, the “Liga de Cooperativas” (Cooperatives League) was formed to promote the cooperative movement in Puerto Rico. Years later, in the 1970s and 1980s, savings and credit, insurance and housing cooperatives on the Island boomed.

It was during this time that the government started the Savings and Credit Cooperative Shares and Deposits Insurance Corporation (PROSAD-COOP, by its Spanish acronym) Program under

Law 99-1980. This program insured the shares and deposits of the members of the savings and credit cooperatives up to \$40,000 per member. PROSAD-COOP's objective was to place cooperatives on an equal competitive footing with commercial banks that were able to offer deposit accounts covered by the FDIC.

In the 1990s, the insured cooperative system weakened financially. As PROSAD-COOP looked to raise insurance coverage given to cooperatives, cooperatives incurred losses. After several failed attempts to restructure the program, the Public Corporation for Supervision and Insurance of Cooperatives (COSSEC, by its Spanish acronym) was established in 2001, as a means to improve operations and return cooperatives to stronger financial conditions, provide stronger regulatory oversight, and unify the cooperative system as a whole. Most recently, COSSEC was designated as a Covered Entity under Section 101 of PROMESA on September 30, 2016, due to a group of insolvent cooperatives that threatened the solvency of the COSSEC Insurance Fund and the stability of the cooperative system and the slow response of COSSEC as insurer and regulator to address the issue.

Significance of the Cooperative system in Puerto Rico

Today, COSSEC acts as the regulatory body for the cooperative system, which serves one-third of the Island's population and is a critical component of the Island's economy, with more than 1 million cooperative members. Furthermore, cooperatives mostly serve low-to-middle-income populations. Apart from the financial benefits that cooperatives bring to municipalities throughout the Island, the cooperative system also plays an important role in serving local communities, particularly outside of San Juan and other population centers. This has become particularly evident during events like Hurricanes María and Irma in 2017, the earthquakes in the municipalities of the south of Puerto Rico in late 2019-20, and the still on-going COVID-19 crisis, as cooperatives serve as an economic anchor for families' and communities' critical food and relief supplies and cash assistance. Cooperatives also contribute to financial inclusion ("access to useful and affordable financial products and services"²), which is one of the principal conditions required for economic and social participation of members in a society. The United Nations has identified financial inclusion as an enabler for seven of the 17 Sustainable Development Goals, and it is considered by the World Bank as a key lever in mitigating extreme poverty and boosting shared prosperity. Similarly, research reveals that hunger, poverty, and gender inequality, among others, are reduced when countries strategically advance financial inclusion through the collaboration of actors in the public, private and social spheres³.

Lack of universal access to basic financial products and services (such as credit, savings accounts, insurance, or electronic transfers) is a problem in the US and around the world. According to the FDIC, 6.5% of US households are unbanked (8.4 million households, with 14.1 million adults), and 18.7% of households are underbanked (24.2 million households, with 48.9 million adults).

² World Bank. (2022). *Financial Inclusion*. Retrieve from: <https://www.worldbank.org/en/topic/financialinclusion>

³ World Bank. (2019). *The Global Findex Database 2017 Measuring Financial Inclusion and the Fintech Revolution*. Retrieve from: <https://globalfindex.worldbank.org/>

Without the means to save, invest, or start a business, individuals lose significant economic potential, and communities are impoverished.

Consequently, public, and private organizations and structures exist to promote equality, productivity, and development in areas of economic exclusion. Financial cooperatives, which are owned and operated by and for their members, embody this idea as entities of social character that grant access to financial services for otherwise unserved populations. Puerto Rico is no exception, as its cooperative system is an important network that has allowed disadvantaged groups, such as the elderly or low-income families, to access the formal financial system. An example of this is the fact that only 15 days after Hurricane María, 90% of cooperatives were servicing members of their communities, and 30 days after it, cooperatives were the only functioning financial institutions in 17 municipalities.

Cooperative system overview

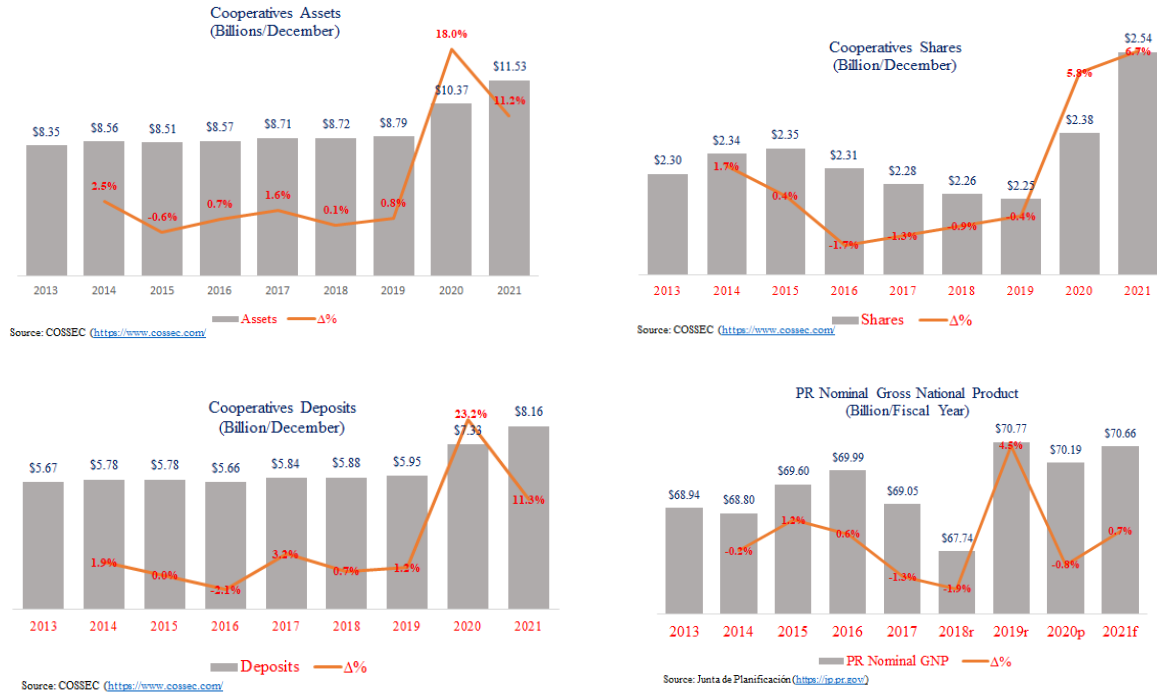
Similar to credit unions on the U.S. mainland, the cooperative system's members are also its owners, with a maximum shares and deposits insurance limit of \$250,000 per person. COSSEC's system is composed of 109 locally chartered, regulated, and insured credit unions, holding ~\$8.2 billion in shares and deposits. Although the total number of cooperatives has decreased in the past 20 years, insured deposits and shares have increased.

Asset base & funding sources

The cooperative system continues to attract more than one million of Puerto Rico's low-to-middle-income population who depend on cooperatives for access to financial services, and it continues to stimulate local initiative and local economic strength. This suggests the relevance it has in driving economic development in Puerto Rico and in advancing financial inclusion for its population. In recent years, cooperatives' customer base has continued to increase, and collective system assets have grown 38.1% between 2013 and 2021 (CAGR of 3.65%) because of an increase in shares of 10.4% (CAGR of 1.11%) and deposits of 43.9% (CAGR of 4.13%) respectively. Despite the six-month lag in data, the increase in shares and deposits follows for the most part the trend of Puerto Rico's nominal gross national product (GNP) as result of receiving the positive impact of the surge in deposits in cooperatives associated with the three rounds of payments of the Federal Government stimulus programs, including CARES Act (\$1,200 per adult), Consolidated Appropriations Act (\$600 per adult) and American Rescue Plan (\$1,400 per adult)⁴, as well as federal unemployment transfers, in response to the COVID-19 pandemic (see Chapter 13 for more details). This increase in deposits provides cooperatives with the opportunity of increasing funds that could be loaned or invested taking in consideration the cooperatives' risk tolerance, reserve requirements and future funding needs related to asset liability management.

⁴ Peterson Foundation. (2021) *What to know about all three rounds of Coronavirus stimulus checks*. Retrieve from: <https://www.pgpf.org/blog/2021/03/what-to-know-about-all-three-rounds-of-coronavirus-stimulus-checks>

EXHIBIT 1: ASSETS, SHARES, DEPOSITS & PR GNP (\$ BILLION)



One way to look at the contributions of financial cooperatives to the local economy is through the salaries and employment generated by its full-time employees, which helps sustain sales of good and services of local business and taxes to municipalities and central government. Most of the salaries are generated by the cooperatives located in the north and east sections of Puerto Rico with 31% and 21% of total respectively or more than half combined (52%).

A convergent trend is reflected in the number of full-time employees, with the North and the East respectively obtaining 28% and 20% of the total, or almost half. In the case of cooperatives' members, more than one million of Puerto Rico's low-to-middle-income population depend on cooperatives for access to financial services. Once again, the North and the East, with 32% and 18% respectively, collectively account for about half of the total number of cooperatives' members. Another pattern is reflected in terms of the metropolitan area's surpassing in full-time salaries and employment (11.4% & 14.2%) other traditional cooperative regions such as the West (10.9% & 11.8%) and the South (7.1% & 8.6%).

EXHIBIT 2: EMPLOYEES & MEMBERS BY GEOGRAPHIC LOCATION

Cooperatives Full Time Employees			Cooperatives Full Time Employees			Cooperatives		
Geographic Location	Salaries	Percent	Geographic Location	Number	Percent	Geographic Location	Members	Percent
North	\$23,199,926	30.5%	North	844	28.0%	North	355,979	32.4%
East	\$16,081,261	21.2%	East	600	19.9%	East	196,854	17.9%
Center	\$14,357,282	18.9%	Center	524	17.4%	Center	186,651	17.0%
Metro	\$8,635,433	11.4%	Metro	429	14.2%	West	152,582	13.9%
West	\$8,247,794	10.9%	West	357	11.8%	Metro	115,640	10.5%
South	\$5,426,497	7.1%	South	260	8.6%	South	91,535	8.3%
Total	\$75,948,193	100.0%	Total	3,014	100.0%	Total	1,099,241	100.0%

Notes:

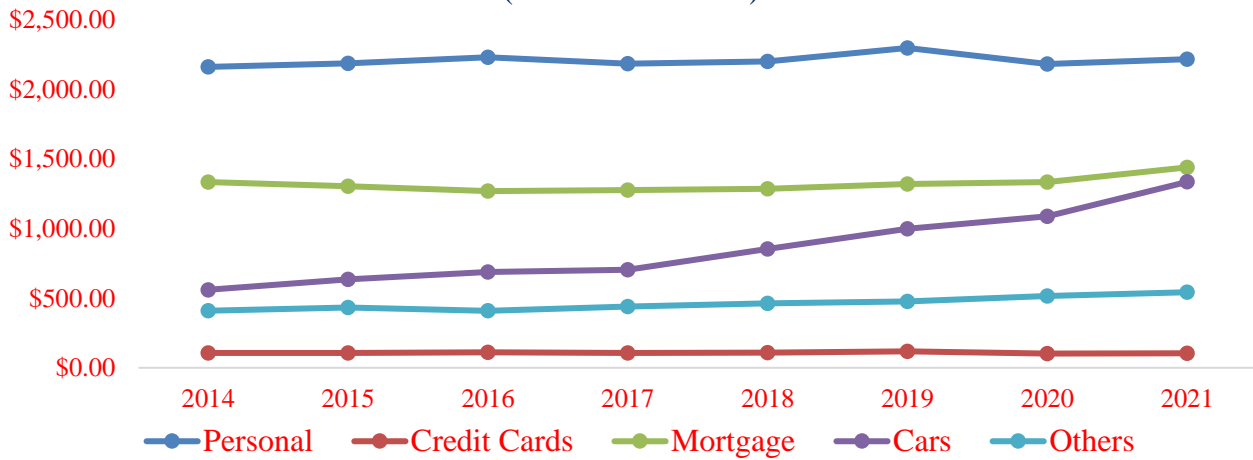
1. Data submitted by COSSEC as September 2020.
2. Cooperatives salaries, employees and members distribution based on the location of main office.

Loan portfolio composition

In line with the socially driven mission of cooperatives, oftentimes members' deposits and shares are pledged as the guarantee for loans. When it comes to the cooperative loan portfolios, \$2,219 million are personal loans, \$1,440 million mortgage loans, \$1,336 million cars loans, \$104 million credit cards, and \$543 other loans (as of December 2021). Of these, 44% have physical collateral, which reduce the chance of loss in a default scenario. The 2021 CCFP (p. 12) emphasized that cooperatives' car loans growth exceeded other loan types. Updated data reflects that car loans more than doubled from \$560.91 million in 2014 to \$1,335.95 million in 2021 (Exhibit 1) or 138.2% (CAGR 11.5%). During the same period, cooperatives' assets increased from \$8,557.57 million to \$11,526.75 million or 34.7% (CAGR 3.8%), which means that car loans increased 4 times over total assets. The growth of car loans is likely a result of cooperatives serving a need in the market. Auto purchases have grown in recent years, while the traditional banking sector has consolidated. Cooperatives have again shown the important role that they play in communities across Puerto Rico by meeting these needs. As the regulator of the cooperative system and deposit insurer, COSSEC's role is to ensure that cooperatives have appropriate risk management and underwriting procedures in place. Without confidence in these practices, the cooperatives could be pursuing rapid growth that could cause issues down the road. Based upon the data trend, the Oversight Board requests that, **within 60 days after certification of this 2022 CCFP, COSSEC submit a report of car loans by each financial cooperative with the dollar amount of car loans, average FICO score (or its equivalent) and interest rate. The report also must provide recommendations within the actual legal framework for COSSEC as regulator to oversee this exposure and propose future limitations to reduce such exposure, as appropriate.**

EXHIBIT 3: LOAN PORTFOLIO COMPOSITION - LOANS BY TYPE (\$ MILLION)

Cooperatives Loans (Million/December)



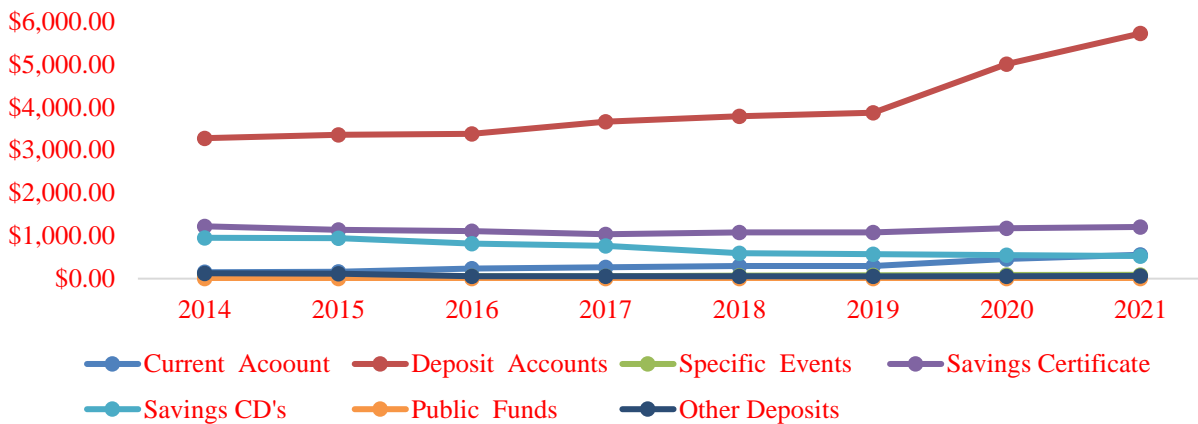
Source: COSSEC (<https://www.cossec.com/>)

Deposit composition

The cooperative system holds \$8,165 million in deposits. These deposits are mainly made up of \$5,721 million of deposits accounts, \$1,204 million savings certificate, \$557 million operating accounts, \$528 million certificate of deposits (“CDs”), \$89 million and \$65 million specific events and other deposits respectively. Certificates of Deposit (“CDs”) consist of a lump-sum that is “locked-up” for a longer period of time in exchange for an interest premium, and early withdrawal usually results in a penalty for the depositor.

EXHIBIT 4: DEPOSIT COMPOSITION - DEPOSITS BY TYPE (\$ MILLION) AS OF DECEMBER 2020

Cooperatives Deposits (Million/December)



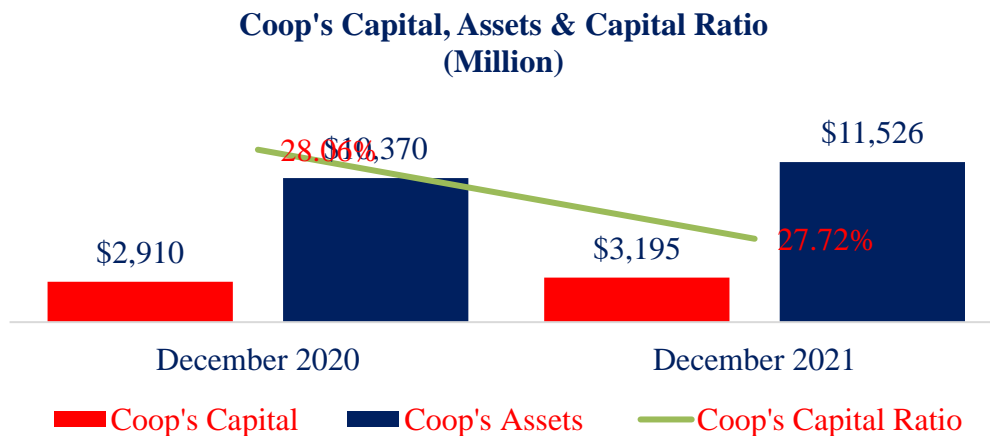
Assets, Liabilities & Capital

As of March 2020, the cooperative system had the following assets and liabilities composition:

EXHIBIT 5: COOPERATIVES' ASSETS, LIABILITIES AND CAPITAL AS OF DECEMBER 2020 & 2021

December 2020			
Assets (\$ million)		Total Deposits	\$7,331
Cash	\$898	Account Payable	\$129
Total Loans	\$5,223	Total Liabilities	\$7,460
Loan Loss Provision	-\$126	Shares	\$2,377
Savings Accounts & Certificates	\$1,770	Capital Obligations	\$5
Total Investment in Securities	\$1,563	Indivisible Capital Reserve	\$360
Total Investment in Cooperatives	\$306	Investment Valuation Reserve	\$6
Land & Property	\$337	Other Reserves	\$230
Other Assets	\$399	Surplus	-\$68
Total Assets	\$10,370	Total Equity	\$2,910
<small>Source: COSSEC (https://www.cossec.com/)</small>		Total Liabilities + Equity	\$10,370
December 2021			
Assets (\$ million)		Total Deposits	\$8,165
Cash	\$1,028	Account Payable	\$166
Total Loans	\$5,642	Total Liabilities	\$8,331
Loan Loss Provision	-\$146	Shares	\$2,536
Savings Accounts & Certificates	\$2,010	Capital Obligations	\$11
Total Investment in Securities	\$1,950	Indivisible Capital Reserve	\$357
Total Investment in Cooperatives	\$322	Investment Valuation Reserve	-\$11
Land & Property	\$319	Other Reserves	\$294
Other Assets	\$401	Surplus	\$8
Total Assets	\$11,526	Total Equity	\$3,195
<small>Source: COSSEC (https://www.cossec.com/)</small>		Total Liabilities + Equity	\$11,526

EXHIBIT 6: CAPITAL, ASSETS & CAPITAL RATIO COMPARISON AS OF DECEMBER 2020 & 2021



Overview of COSSEC

Under Act 114-2001, COSSEC serves as the regulatory body for the Island's cooperatives and its main function is oversight of both credit and savings cooperatives and non-financial cooperatives. Its jurisdiction also includes the consolidation of financially distressed cooperatives, technical assistance and personnel training. COSSEC also insures shares and deposits up to \$250,000 per person to protect members from losses caused by a cooperative's inability to pay its debts when due.

COSSEC's main powers and responsibilities

Under Act 114-2001, COSSEC is the system regulator and insurer of deposits for the cooperative system. Its main powers and responsibilities include:

- Comprehensive oversight and supervision of cooperatives to ensure compliance with regulations regarding their operations, businesses, products, and/or services.
- Providing shares and deposit insurance for savings and loans cooperatives.
- Ensuring economic solvency of cooperatives, particularly credit and savings cooperatives.
- Ensuring rights and prerogatives of cooperatives' partners, protecting their financial interests and their right to be informed, and
- Preventing deceitful and fraudulent practices in the offer, sale, purchase, and any other transaction of cooperatives.

Under these guiding principles, COSSEC's mandate includes guaranteeing the economic stability and soundness of the Puerto Rico cooperatives and, consequently, protecting its members and their deposits.

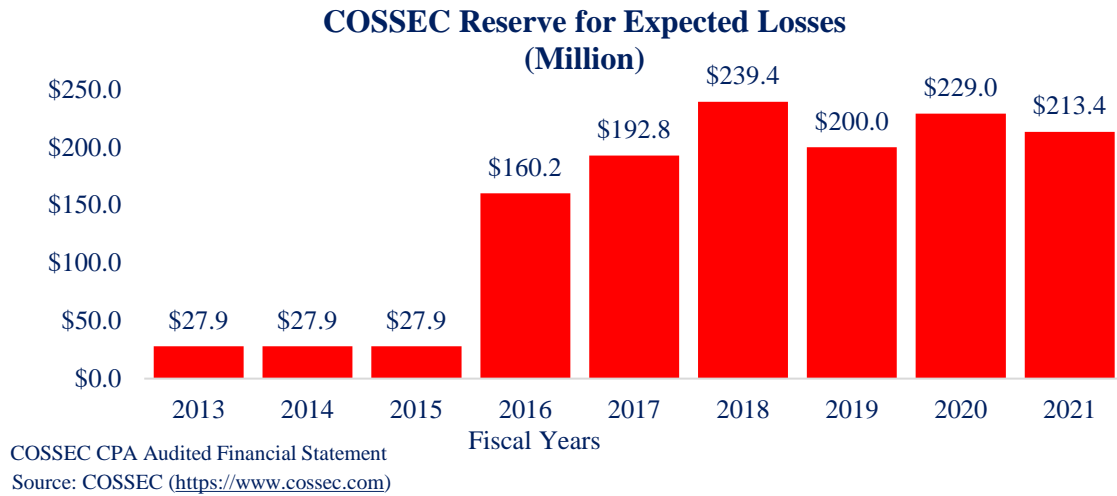
COSSEC's provision for losses

COSSEC's actuary projected a reserve for known losses that includes potential losses from cooperatives currently under COSSEC receivership or potential candidates to be in receivership in the future. The reserve for unknown losses also includes the remaining cooperatives, based on their estimated financial risk.

During fiscal years 2013 through 2015, the COSSEC reserve for expected losses (including administrative adjustment) maintained a stable pattern of around \$28 million. After 2015, the reserve increased steadily up to \$229 million in 2020, with a reduction of 7% in 2021 to \$213 million. From 2018 to 2021, COSSEC's reserve average for expected losses was around \$220 million.

This historical trend of the COSSEC reserve for expected losses reflects a persistent risk that still undermines the full potential of the cooperatives system and the COSSEC Insurance Fund if it is not decisively addressed. Although there has been progress in the implementation of some of the reforms outlined in 2020 CCFP and 2021 CCFP, there is still work to be done. The Oversight Board continues to urge the Government and COSSEC to take actions to ensure the stability of the cooperative system. Further delays, such as merely requiring capitalization plans for insolvent cooperatives since 2017 (in most cases) as opposed to taking action to address the issue, will only exacerbate the risks in the cooperative system.

EXHIBIT 7: COSSEC RESERVE FOR EXPECTED LOSSES (FISCAL YEAR)



COSSEC Insurance Fund

In terms of investment portfolio composition, COSSEC has \$337 million in total investments (market value), including US municipal bonds (36%), US corporate bonds (31%), US Agencies (18%), mortgage-backed securities (15%), and US Treasury bonds (2%). Portfolio risk and return analytics of an average credit rating of AA, average coupon rate of 3.38%, and a yield to maturity of 2.86%.

Exhibit 8: COSSEC Insurance Fund

Investment Detail (000's)	12/31/2020	%	Investment Detail (000's)	12/31/2021	%
PR Debt	\$0	0%	PR Debt	\$0	0%
Mortgage-Backed Securities	\$90,873	27%	Mortgage-Backed Securities	\$49,044	15%
US Corporate Bonds	\$76,704	23%	US Corporate Bonds	\$102,775	31%
US Treasury	\$19,834	6%	US Treasury	\$5,239	2%
US Agencies	\$30,518	9%	US Agencies	\$59,391	18%
US Munis	\$108,514	32%	US Munis	\$120,352	36%
Other	\$11,441	3%	Other	\$0	0%
	\$337,884	100%		\$336,801	100%

Volatility in financial markets due to the increase in inflation⁵, geopolitical risk, and the increase of interest rates by the Federal Reserve⁶ requires that COSSEC include metrics of risk management to measure and control sudden fluctuations in the market value of COSSEC’s investments. To that end **COSSEC must submit a risk management report of the COSSEC Insurance Fund within 90 days after the certification of this 2022 Fiscal Plan** with a stress

⁵ Guilford, G. (2022). U.S. Inflation Hit 7% in December, Fastest Pace Since 1982. Wall Street Journal. Retrieve from: <https://www.wsj.com/articles/us-inflation-consumer-price-index-december-2021>.

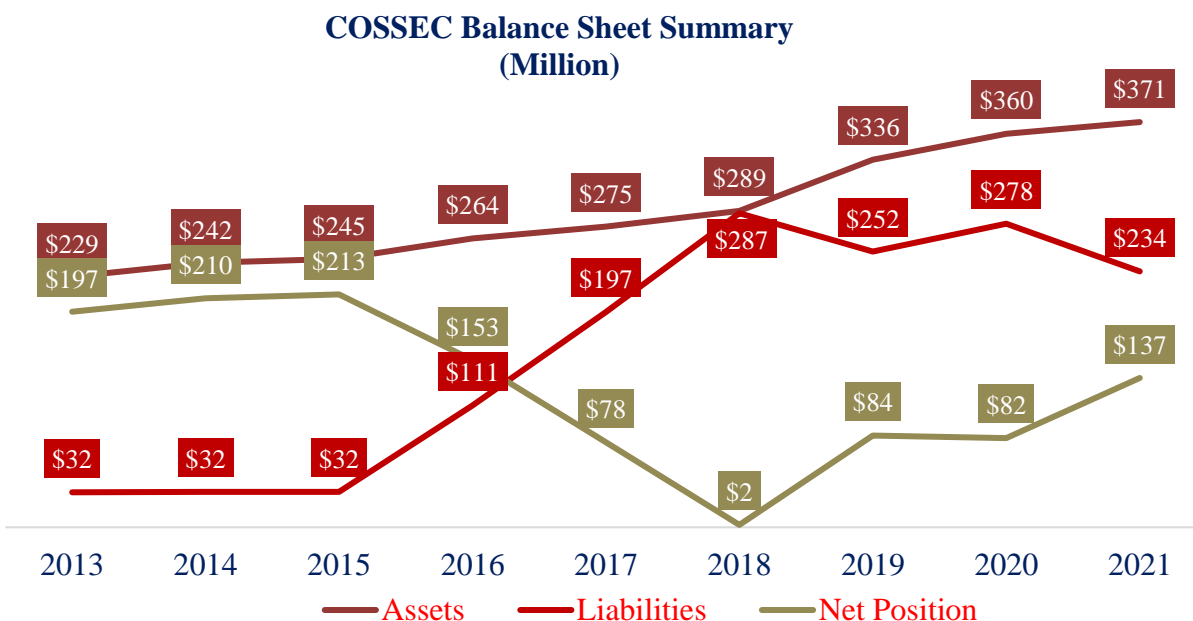
⁶ Federal Reserve. (2022). *Federal Reserve Press Release*. Retrieve from: <https://www.federalreserve.gov>

test of the change in the market value of the COSSEC Insurance Fund under scenarios of interest rate increases of 100, 200 and 300 basis points (bps). The stress test must include recommendations for how COSSEC can handle expected reductions to the insurance fund as a result of addressing insolvent cooperatives at a time where increases in interest rates may be rising.

COSSEC historical balance sheet summary

From 2013 to 2015, COSSEC’s assets and net position were growing steadily from \$229 million to \$245 million and \$197 million to \$213 million respectively, while COSSEC’s liabilities remained fixed at \$32 million. While assets continued to advance from \$264 million in 2016 to \$289 million in 2018, COSSEC’s net position was reduced sharply to \$153 million in 2016 and just \$2 million in 2018. At the same time, COSSEC’s liabilities went up to \$111 million in 2016 and to \$287 million in 2018, almost at the same level as COSSEC’s assets. COSSEC’s assets continued to surge from \$336 million in 2019 to \$371 million in 2021, while COSSEC’s net position and liabilities finished at \$137 million and \$234 million respectively. The reduction in COSSEC’s net position relative to COSSEC’s assets from 86% in 2013 to 37% in 2021 reflects the impact of the increase in the reserve for expected losses as part of the liabilities (91% of COSSEC’s liabilities).

EXHIBIT 9: COSSEC BALANCE SHEET



COSSEC CPA Audited Financial Statement
 Source: COSSEC (<https://www.cossec.com>)

Key stakeholders in the Cooperative System

The Oversight Board has consulted a broad range of stakeholders in order to inform its efforts to develop this fiscal plan and improve the conditions of the cooperative system. Those stakeholders included government and private sector stakeholders, as well as representatives of the cooperative movement itself such as Liga de Cooperativas de Puerto Rico (“LCPR”), G-25, Life Insurance Cooperative of Puerto Rico (“COSVI”), the Banco Cooperativo de Puerto Rico (“BCPR”) and Alianza de Cooperativas (“Cooperatives Alliance”).

Topics of discussion with these groups included (but were not limited to): financial inclusion and service to communities across Puerto Rico, governance reforms for COSSEC, measures to address or reduce systemic risks, resolution of cooperatives with financial concerns, transition from RAP accounting to GAAP accounting, COSSEC insurance funding, and approaches to allow institutions other than cooperatives to participate in transactions to resolve cooperatives with financial concerns (Article 7.02 of Act 255 of 2002).

As the Oversight Board has engaged with stakeholders, some have raised questions about the effect that a surge in cooperatives’ branches and service offices has had on return on assets (ROA), particularly in light of the long-term reduction in population in Puerto Rico. This surge in cooperative branches has happened while local commercial banks have reduced branches by of 43% between 2006 and 2016⁷. While an increase in cooperative branches may have benefits in certain communities, COSSEC must ensure that the branch network is sustainable given the resources of the cooperative system. From that standpoint, **within 224 days after the certification of this 2022 Fiscal Plan, COSSEC must submit a report of the cooperatives’ authorizations awarded by COSSEC to establish branches and service offices with ROA before and after the approval of a branch or service office from fiscal years 2016 through 2021.**

Chapter 2. Financial challenges facing the cooperative system

Despite the significance of the cooperative system to the economy of Puerto Rico, in recent years it has been threatened by internal and external factors that have resulted in under-capitalization that, if not promptly addressed, could jeopardize the cooperatives’ ability to maintain their financial safety and soundness.

There are still several key drivers that must continue to be monitored through the system and second-order effects to COSSEC. These include investments that cooperatives hold in bonds of the Government of Puerto Rico and its instrumentalities, cross-deposits and deposits in second-degree cooperatives, and shortcomings in the governance and administration of cooperatives and COSSEC.

⁷ El Vocero. (2017). Drástica reducción de sucursales bancarias en la Isla. Retrieve from: <https://www.elvocero.com/economia/drastica-reduccion-de-sucursales-bancarias-en-la-isla>

Investments in government bonds and its instrumentalities

In 2002, under Act 255 of 2002 or the Cooperative Savings and Credit Companies Law (Act 255-2002), all cooperatives could buy (1) Treasury securities (bills, notes and bonds), (2) US Agency bonds (GSEs) and (3) US Municipal Bonds (AAA & AA). Pursuant to Act 255-2002, Regulation 7051 of 2005 allowed “adequate condition Coop’s” to also invest in additional investments, specifically (4) US Corporate Bonds (AAA & AA), (5) US Asset Backed Securities, (6) US Mortgage-Backed Securities (“MBS”) and (7) US Collateral Mortgage Obligation (“CMOS”). Regulation 7051 of 2005 leverages the CAMEL⁸ international rating system to differentiate between adequate condition cooperatives and other cooperatives (with only adequate condition cooperatives being able to invest in those additional security types).⁹ CAMEL is used to score institutions between one (best) and five (worst), with any score higher than a three being considered less-than-satisfactory.¹⁰ Pursuant to Regulation 7051, cooperatives ranked between one and three were determined to be adequate and hence could diversify the bond types in which they invested, while the remainder were limited to the three initial bond types.

Cross-deposits and deposits in second-degree cooperatives

The cooperative system relies on certain secondary cooperatives to provide insurance and supporting banking services, including COSVI, Cooperativa de Seguros Múltiples, and BCPR.

By regulation, cooperative members invest in these entities and serve on their management boards. Because of this structure, cooperatives have financial exposure via cross-deposits across cooperatives (\$555 million) and BCPR (\$774 million). COSSEC has increasingly been challenged to understand and manage the risks from the inter-connected web of financial relationships.

For example, to the extent that there are linkages with insurance providers, COSSEC must understand the underlying financial health of those providers in order to evaluate the risk that cooperatives’ investments could lose value. In the case of cross-deposits, COSSEC’s analysis of stress scenarios at the individual cooperative level may not fully capture the system-wide risks involved when multiple cooperatives hold deposits with each other.

Between December 2015 and December 2020, cross-deposits between cooperatives have seen a significant decrease. By year end 2015, for example, cross-deposits in the system were \$946

⁸ Corporación Pública para Supervisión y Seguro de Cooperativas de Puerto Rico (COSSEC). (2021). *Reglamento para Establecer el Sistema de Evaluación Financiera Camel*. Retrieve from: https://www.cossec.com/cossec_new/publications

⁹ Corporación Pública para Supervisión y Seguro de Cooperativas de Puerto Rico (COSSEC). (2021). *Reglamento de la Ley de Sociedades Cooperativas de Ahorro y Crédito*. Retrieve from: https://www.cossec.com/cossec_new/publications

¹⁰ Federal Reserve Bank of San Francisco. (2021). *Using CAMELS Ratings to Monitor Bank Conditions* Retrieve from: <https://www.frbsf.org/economic-research/publications/economic-letter/1999/june/using-camels-ratings-to-monitor-bank-conditions/>

million compared to \$555 million in 2021. This 41% decrease is a key indicator of the steady liquidity improvements within the cooperative system. The proportion of cross-deposits within total deposit composition is another illustration of how the system is recovering. During 2015, the \$946 million in cross-deposits made up approximately 16% of total deposits in the system (\$5.8 billion total). In contrast, by December 2020 these deposits only made up roughly 8% of total deposits of \$7.33 billion within the system. The case of cooperatives' exposure to other cooperatives could represent a higher cost to the COSSEC Insurance Fund when implementing a final resolution to insolvent cooperatives, especially in cases of cross-deposits over the insurance limit.

Given the above, it is important to further differentiate between cross-deposit involving insolvent and solvent cooperatives, as well as whether those cross-deposits reach COSSEC's shares and deposits insurance limit or exceed it. This additional data will allow COSSEC to realistically measure the actual potential impact to the COSSEC Insurance Fund of those cross-deposits. **Within 180 days after certification of this 2022 Fiscal Plan, COSSEC must submit a report setting forth the amount and number of cross-deposits based on limits of the shares and deposits insurance (above and below \$250,000) among solvent and insolvent cooperatives.**

Cooperatives' exposure to other cooperatives and to BCPR could be considered as a systemic risk based on the guidelines of the Basel Committee on Banking Supervision (Basel Committee). The Basel Committee guidelines identify the need to "strengthen oversight and regulation" as a key element to mitigate the systemic risk arising from interactions within financial institutions that could be in distress. Another important element considered by the Basel Committee is the "liquidity support" necessary to face financial interconnection during potential crisis.¹¹

The Oversight Board recognizes the importance of BCPR in providing banking services to cooperatives, and, based on the information provided, BCPR has maintained healthy capital ratios¹² comparable with local commercial banks. Furthermore, the Oversight Board believes that a holistic financial assessment of a bank from the perspective of federal regulators should include asset quality, management, earnings, liquidity, and sensitivity to market risk, in addition to capital.

To monitor the exposure of COSSEC insured cooperatives and ultimately COSSEC Insurance Fund to the BCPR, **the Oversight Board requires that BCPR and OCIF submit the relevant updated financial reports of BCPR within 90 days after the certification of the 2022 Fiscal Plan.**

Geopolitical and other Risks

Puerto Rico has suffered several events that have deeply impacted its residents and communities. Hurricanes María and Irma in September 2017, and the series of earthquakes that hit the Commonwealth for months in December 2019 and January 2020, caused catastrophic damage to

¹¹ Bank for International Settlements. (2021). *Identification and management of step-in risk*. Retrieve from: <https://www.bis.org/bcbs/publ/d423.pdf>

¹² Federal Deposit Insurance Corporation. (2022). *Risk Management Manual of Examination Policies*. Retrieve from: <https://www.fdic.gov/regulations/safety/manual/section2-1.pdf>.

Puerto Rico’s people and businesses, and left billions of dollars in damages. The cooperative system proved to be resilient through these disasters and played an important role in enabling the recovery process to start. Just 15 days after Hurricane María, 90% of cooperatives were serving their communities, and \$1.43 billion was granted in loan moratoria.

As in all jurisdictions around the world, the global COVID-19 pandemic, rising fuel prices and rising inflation in the United States resulting from the “supply and demand imbalances”¹³ have taken an enormous toll on communities across Puerto Rico. On March 12, 2020, Puerto Rico entered a state of emergency, and later, on March 15, 2020, a strict lock-down was imposed to curb the spread of the virus. In FY2020 there was sharp economic contraction, followed by recovery in FY2021 as the combined effect of federal economic relief funds and rollout of highly effective vaccines has taken hold. Yet in the first quarter of 2022, of US economy GDP suffered a decline of -1.4%.¹⁴

While the outcome is not yet clear and the situation is evolving rapidly, it is reasonable to conclude that the prospects of how Puerto Rico, as an open economy connected to the world, will recuperate are highly indeterminate. The forecast of Puerto Rico’s economy depends on a set of exogenous variables such as United States economy, Puerto Rico’s exports, visitors’ expenses, federal transfer payments, interest rates and crude oil price.¹⁵

Chapter 3. COSSEC efforts to date

Analysis of capital adequacy

Many cooperatives have accumulated losses that threaten their long-term viability and solvency. Those include a number of insolvent and undercapitalized cooperatives that have accumulated millions in losses not solely related to losses related to investments in Puerto Rico bonds.

The use of actuarial methodology (RAP) has allowed the masking of losses and created the appearance of stronger financial health in cooperative financial statements.

COSSEC has provided a stress test scenario¹⁶ that adjusts cooperatives’ current financial reporting in the following ways:

- **Market Value adjustment:** value assets including Puerto Rico Government Bonds at market value

¹³ Federal Reserve. (2020). *Press Release*. Retrieve from: <https://www.federalreserve.gov/>

¹⁴ Cambon, S. (2022). U.S. GDP Falls 1.4% as Economy Shrinks for First Time Since Early in Pandemic. *Wall Street Journal*. Retrieve from: <https://www.wsj.com/articles/us-economy-gdp-growth-q1>

¹⁵ Junta de Planificación. (2021). *Proyecciones Económicas a Corto Plazo*. Retrieve from: <https://jp.pr.gov/>

¹⁶ From the perspective of the Federal Reserve and in the context of the COSSEC Fiscal Plan, stress test is an “evaluation of the resilience” of cooperatives by estimating capital adequacy under hypothetical scenarios into the future.

- **ALLL adjustment:** add 50% of TDRs and 6+mo. delinquent loans where greater than ALLL.
- **OREO adjustment:** write-down of 50%.
- **COSVI adjustment:** 100% write-down of investment in COSVI.¹⁷
- Estimated loss to COSSEC based on 20% of assets' historical average loss given failure for FDIC and NCUA.

COSSEC also has undertaken an analysis to understand what level of capitalization would be required for cooperatives to reach a 6%, 10% and 20% target capitalization based on NCUA standards. The need for this level of resources, and the time frame in which it is required, will depend on a variety of factors. However, it provides an overview of the extent to which cooperatives in the system need to build resources in the interest of long-term resilience. It also informs COSSEC's forecast of what reserves COSSEC will need to ensure that it can effectively operate as a provider of deposit insurance.

Actuarial Risk Level Priorities

Within COSSEC's actuarial report, four cooperative categories have been defined based on the extent of capital requirements they are facing. Specifically:

- *Priority 1:* Currently unable to cover accumulated losses (negative capital before running analysis).
- *Priority 2:* ROA is negative, meaning that even after the 15-year loss amortization, the cooperative would still be unable to generate positive earnings.
- *Priority 3:* Projected ROA is positive but may not be sufficient to cover amortized losses on investments (negative net ROA) and could amortize with or without assistance.
- *Priority 4:* Positive projected ROA enough to cover losses on investments without assistance.

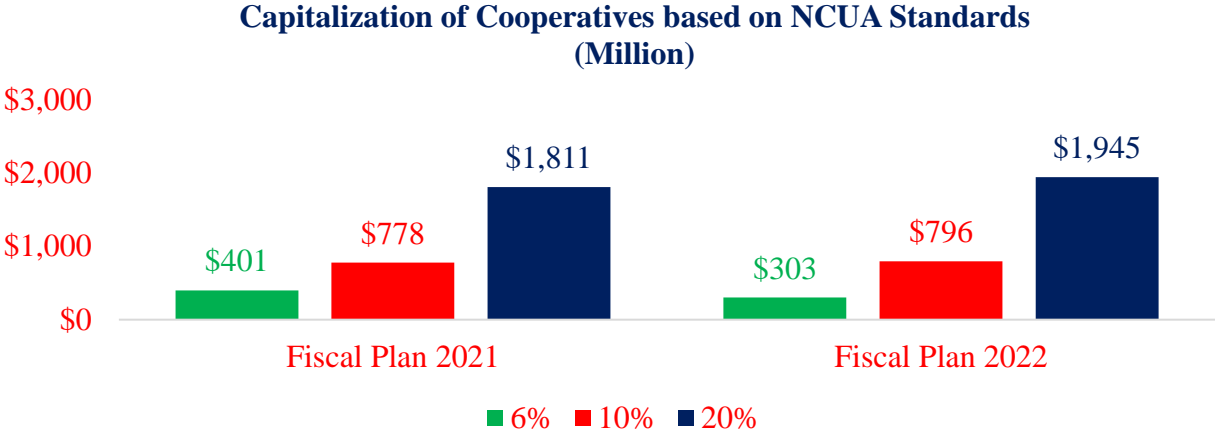
This 2022 CCFP requires COSSEC to develop and commit to a plan to identify and address any cooperatives that are currently insolvent and undercapitalized (priorities 1 and 2), and that generate risks and higher insurance premium payments for the healthier cooperatives.

The NCUA analysis assessed the ability of the cooperative system to withstand a financial shock based on a series of assumptions included in chapter 3 above. NCUA standards define as "well-capitalized" a capitalization rate of not less than 7%, "adequately capitalized" is a capitalization rate of not less than 6%, and "undercapitalized" is a capitalization rate of less than 6%. In the case of the cooperatives, NCUA analysis includes three parameters of target capitalizations of 6%, 10% and 20%. According to COSSEC, the NCUA 6% capitalization requirement decreased from \$401 to \$303, but the 10% capitalization requirement increased from \$778 to \$796, and 20% capitalization requirement also increased from \$1,811 to \$1,945. The fact that the previous data could require further revision, nevertheless, reflects that while COSSEC has continue to take the

¹⁷ The inclusion of the "COSVI adjustment" as part of the stress test scenario assumptions is for mathematical purposes and does not constitute a financial assessment of COSVI's financial health.

corrective actions, there is still work to be done toward a better-capitalized cooperative system able to withstand a financial shock.

EXHIBIT 10: CAPITALIZATION OF COOPERATIVES SYSTEM BASED ON NCUA STANDARDS



Liquidity stress scenarios

COSSEC also conducted liquidity stress scenarios. The analysis, which is typical for banking regulators to require, considers what would happen in the case of a sudden withdrawal of funds from the cooperative system. For example, during a time of media reporting about the vulnerability of the cooperative system in 2016, there was a system-wide run withdrawal of approximately 4% of total deposits. Using deeper stress scenarios, COSSEC must ensure that it has a plan and financial resources available to maintain high levels of depositor confidence.

Part II: Reform measures to the cooperative system

Chapter 4. Measures required to improve governance, oversight, and supervision

COSSEC, individual cooperatives and all stakeholders should work together to ensure the strength and reliability of the cooperative system via effective regulation and strong insurance. This will require a much more assertive posture, as COSSEC must improve the resiliency of the system, by, among other measures, adopting reforms that have been discussed for years, but have been consistently deferred. COSSEC’s governance must be strengthened to allow COSSEC to act quickly, decisively, and in the best interests of the safety and soundness of the cooperative system and to ensure depositor protection. The 2022 CCFP continues to require improving **transparency in accounting and implementing improved supervisory interventions** to protect the integrity of the system. Along these lines, the 2022 CCFP requires **addressing and resolving cooperatives with major financial concerns within 24 months** (i.e., by the end of FY 2023) through a 3-phase intervention process. Taken together, these actions will ensure continued confidence in the

cooperative system and build its long-term resilience aligned with global regulatory best practices, e.g., those employed by U.S. federal regulators such as the NCUA and the FDIC.

Reforms to COSSEC governance

The management processes for the transformation of COSSEC and the cooperative system will require a robust governance model and proper monitoring of cooperative operations. To achieve key reforms to the existing governance structure, protocols, and consequences for mismanagement, COSSEC must have a strong Board of Directors that is able to make decisions independently.

Re-designing governance and establishing protocols

Re-designing governance and establishing protocols is a fundamental process in restoring the cooperative movement. The COSSEC Board of Directors' composition should be reformed to ensure that it is an independent body able to take necessary actions to protect the insurance fund and the depositors who rely upon it. Currently, as per Section 5 of Act 114-2001, COSSEC's board is composed of 9 members, 5 of whom are cooperative members and the remaining 4 of whom are government officials. The existing structure often hinders collaborative oversight and interventions when conflicts of interest arise within the Board. To remove unnecessary restrictions that hinder successful execution of this Fiscal Plan, the following amendments to the Board structure must be undertaken:

- The Board of Directors should be composed of 5 staggered members (to ensure continuity).
- Members should not have any affiliation or financial ties to a cooperative regulated by COSSEC or the cooperative movement
- The Board of Directors should have the following member composition:
 - AAFAF Executive Director
 - Commissioner of Financial Institutions
 - Academic with financial regulation and/or accounting background
 - 2 members with extensive background in private-sector financial services (but not currently affiliated with cooperatives, banks, or credit unions)
- All members of the Board of Directors should have appropriate academic credentials, such as a bachelor's degree in finance and/or accounting as a minimum academic preparation and, preferably, must have completed a postgraduate degree in finance, business administration and/or law in an entity recognized and accredited by the Middle States Association.

The Government and COSSEC must submit and actively promote the enactment of legislation that addresses this change in governance structure for COSSEC's Board of Directors.

Transparency in accounting

Getting an accurate understanding of the state of the cooperative system is currently a challenge because the legal system allows cooperatives to use RAP, and RAP does not require disclosure of the current market value of assets under distress. Specifically, losses incurred by cooperatives are not required to be marked to market, which masks losses and creates the appearance of stronger financial health. This is a major reason why mainland U.S. savings & loan institutions were forced to transition from RAP to GAAP in the aftermath of the savings & loan crisis (see Chapter 13 for more details).

Additionally, RAP treats shares differently than GAAP: under RAP, members' shares are considered as part of the capital, while under GAAP shares are considered a liability. This results in an overestimation of solvency and capital base.

Moreover, this special accounting treatment allowed by Act 220-2015 permits cooperatives to amortize over a 15-year period any losses resulting from the default of Puerto Rico government bonds.

To drive real efficiencies and reforms for the long-term benefit of COSSEC and the cooperative system, COSSEC must require that cooperatives implement improved accounting practices aligned with global best practices for transparency.

The Government must submit and enact legislation during current ordinary session that addresses this critical gap by requiring all cooperatives to convert their accounting books and adhere to GAAP by June 2025. For the avoidance of doubt, when requiring adherence to GAAP, the proposed legislation must also eliminate any special accounting treatment for holdings of Puerto Rico government bonds. A transition from RAP to GAAP will give stakeholders improved transparency into the true financial condition of the cooperative system, closing the gap between local and federal accounting standards.

COSSEC's head accountant and experienced examiners must follow up with individual cooperatives to ensure that the transition of accounting methodologies is done in a timely and precise manner.

Implementation measures to transition from RAP to GAAP must include:

EXHIBIT 11: RAP TO GAAP TRANSITION TIMELINE

<u>Implementation action</u>	<u>Date</u>
▪ Present legislation for transitioning from RAP to GAAP accounting to amend Law 114, Law 220, and Law 255	▪ During Ordinary Session
▪ Implement amendments to Act 220 of 2015 to allow for GAAP accounting to substitute RAP accounting	▪ Widespread implementation by June 2025
▪ Implement amendments to RAP accounting regulation for cooperatives of Regulation 8665 of 2015 under Art 4 of Law 114 of 2001 (Law of COSSEC) - for shares to be considered a liability instead of capital	▪ Widespread implementation by June 2025
▪ Implement accounting standard codification ("ASC") 320-10-35 ("Debt securities") from GAAP	▪ All cooperatives by June of 2025
▪ Implement ASC 320-10-35-20 ("CUSIP" or Committee of Uniform Security Identification Procedures") from GAAP	▪ All cooperatives by June of 2025
▪ Implement ASC 320-10-35-30 (Evaluate Whether an Impairment Is Other Than Temporary) from GAAP	▪ June of 2025

Until a full degree of the transparency in accounting by the transition from RAP to GAAP is achieved by June 2025, the public could take advantage of COSSEC Circular Letter 2017-02, which requires financial cooperatives’ “CPA audited statements” to include a balance sheet and income statement based on GAAP. Even though a considerable number of the financial cooperatives already post their “CPA audited statements” on their internet site, **COSSEC must requiring all financial cooperatives to post their “CPA audited statements” on their own internet site within 120 days after the certification of this Fiscal Plan.**

Improved supervisory interventions

To prevent the increase of accumulated losses of cooperatives with financial concerns, improved supervisory interventions must be adopted in a timely manner to identify risks earlier, and to resolve issues sooner and at potentially lower costs. This is particularly relevant if the economic conditions of Puerto Rico worsen, given COVID-19 or other external shocks that might affect the economic climate.

This process must consist of identifying cooperatives at risk (which has already been done by the COSSEC team), examining capital, liquidity, and operations performance, and implementing timely corrective actions. COSSEC must aim to shorten the time it takes to complete interventions, which will be essential to completing the actions needed over the next 24 months. The detailed steps and actions required are specified below.

1. Identification of cooperatives at risk

In the first phase, COSSEC must classify cooperatives by their level of capitalization and risk. As part of COSSEC's actuarial activities, cooperatives have been categorized under RAP accounting within 4 priority levels. Under current law, COSSEC and cooperatives will have the option of using RAP accounting from actuarial reports that classify at-risk cooperatives. When legislative changes are approved, COSSEC must transition to classifying cooperatives under federal accounting standards. **COSSEC must submit an updated roster of all cooperatives and their risk classification within 45 days after certification of the 2022 COSSEC Fiscal Plan.** Additionally, the 2022 CCFP requires COSSEC to address all cooperatives with major financial concerns (Priorities 1 and 2) by June 2023.

The next two phases must be iteratively conducted based on the conclusions of the risk classification, starting with Priority 1 cooperatives, according to the schedule in Exhibit 15.

2. *Risk examination*

COSSEC examiners must conduct the second phase of intervention. The second phase must be supervised by COSSEC supervisors and the assistant vice-president, with an approximate duration of 20 to 30 days (depending on each cooperative's assets). In this phase, COSSEC must examine priority 1 cooperatives' risk levels through CAEL (unlike CAMEL, CAEL does not evaluate cooperative management). The criteria used are valid both under GAAP accounting and RAP accounting methodologies.

Next, a report consisting of capital, liquidity and continuity of operations analyses must be generated by COSSEC's examiners to determine the probability that a cooperative will be able to continue with its operations. Based on the outcome of this risk examination report, COSSEC must determine which formal and informal corrective actions must be taken to ensure the sustainability and soundness of each at-risk cooperative.

3. *Corrective actions*

In the third phase of intervention, formal and informal measures must be taken to reform cooperatives based on the outcome of the report generated by COSSEC examiners as part of the second phase. The third phase must take no more than 60 days per cooperative, depending on how COSSEC's senior management organizes the work among the legal areas and the technical assistance and supervision areas.

Four potential informal measures may be taken to address *Priority 1* cooperatives, depending on the outcome of the COSSEC examiners' report. These measures fall under operational and shared administration agreements between COSSEC and cooperatives. These measures are not mutually exclusive.

- *Action plan request*
- *Follow-up on action plans*
- *Written warnings*
- *Supervisory visits*

There also are formal measures to be taken by COSSEC. Based upon the examiner's determination, when COSSEC intervenes upon *Priority 1* cooperatives, COSSEC may either send the cooperative a cease-and-desist order to stop suspicious or illegal activities or place the cooperative into receivership. Cooperatives with financial concerns that are subject to intervention should be granted an administrative hearing within 10 days after the intervention. The COSSEC official examiner, the COSSEC lawyer and/or management, and the lawyer and/or management for the cooperative with financial concerns should participate in the hearing. After the administrative hearing, COSSEC's legal examiner should submit a final report, in which he or she should determine whether receivership is justified or not (according to COSSEC's evidence). COSSEC should adjust the length of this process on the cooperative's asset level, but it typically should not exceed 15 business days.

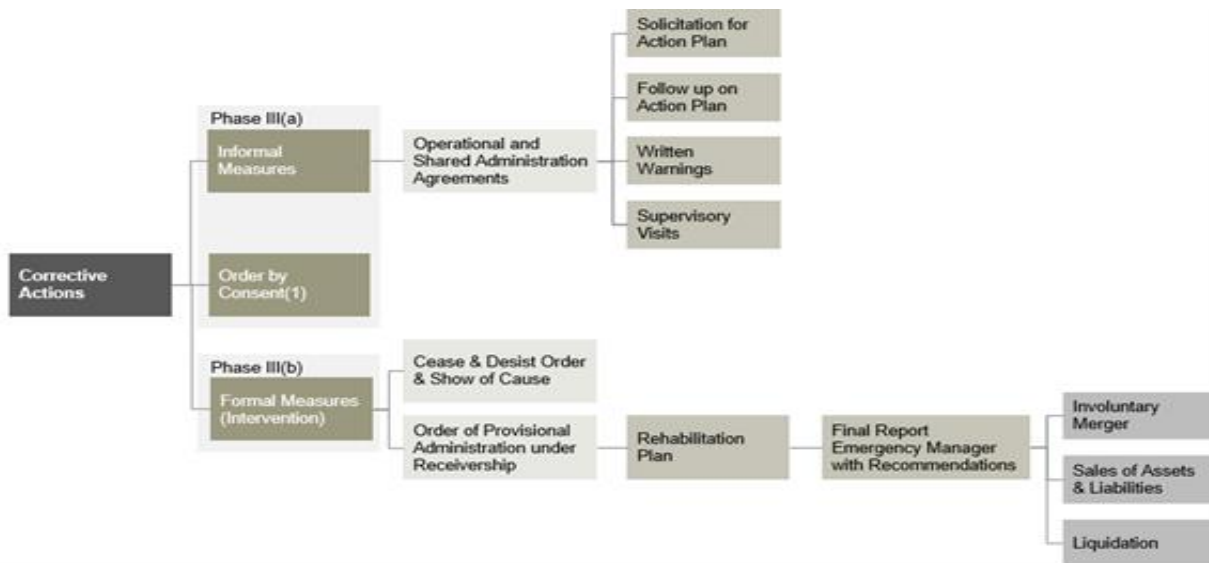
When COSSEC determines that the financial standing of a cooperative is no longer sustainable and that COSSEC therefore needs to intervene, it should place the cooperative into receivership.

COSSEC managers should next generate a rehabilitation plan for the cooperative in question and then prepare a final report with recommendations of 3 potential rehabilitation courses of action (which are mutually exclusive). Finally, COSSEC should select the rehabilitation action that applies to a given cooperative by balancing the two main criteria: the lowest long-term cost to the COSSEC Insurance Fund and systemic risk. COSSEC is required by Section 20 of Act 114-2001 to choose from the below rehabilitation actions:

- *Involuntary merger* with a financially sounder cooperative. Specifically, merging an at-risk cooperative with an operationally sound one, keeping the capital reduction above 8%.
- *Sales of assets and liabilities* to the buyer of the cooperative.
- *Liquidation*, which applies if the cooperative's asset cannot satisfy the cooperative's debts and when there are no prospective investors to which the cooperative can be sold.

In order for phase 3 to be successfully implemented, the Government must seek legislative change to allow COSSEC to successfully intervene and implement final resolution with insolvent cooperatives. The success of this Fiscal Plan depends, in part, on COSSEC convincing the Legislature to repeal article 11.02 (d) of Act 220-2015, pursuant to which COSSEC may not impose sanctions on or require additional reserves from a cooperative due to a cooperative's investments in bonds or notes issued by the Government of Puerto Rico and its instrumentalities. This limitation, as it currently exists, prevents COSSEC from successfully reforming the cooperative system within the established period (24 months).

EXHIBIT 12: COOPERATIVE PHASE 3 INTERVENTION PROCESS



Bidding process for cooperatives with financial concerns

If the rehabilitation plan determines that a cooperative with financial concerns should be resolved through a sale of assets and liabilities (P&A), liquidation or involuntary merger, the following elements should be part of the negotiation between COSSEC and the solvent cooperative's management.

- Insolvent cooperative's accumulated loss
- Insolvent cooperative's capital reserves
- COSSEC's Insurance Fund hit or cost
- Solvent cooperative's indivisible capital
- Impact upon municipality's employment rate
- Impact upon municipality's salaries
- Impact of the cooperative's members to the municipality population
- Geographic location within the Commonwealth

Any negotiated solutions that will impact COSSEC's finances are subject to approval by the Oversight Board. The implementation actions required for a typical resolution process include:

EXHIBIT 13: TIMELINE OF A TYPICAL RESOLUTION PROCESS

Phase	Goal	Milestone	Day (1-90)	
Identifica-tion of co-operatives at risk	Identify cooperatives at risk	<ul style="list-style-type: none"> Conduct actuarial analysis to classify cooperatives into 4 priority levels 	Complete	
	Conduct CAELS examination	<ul style="list-style-type: none"> COSSEC examiner to analyze at-risk cooperative's capital adequacy, assets, earnings, liquidity and sensitivity 	1 to 15	
Risk evaluation	Generate risk examination report	<ul style="list-style-type: none"> Identify capital conditions of at-risk cooperative Identify liquidity condition of at-risk cooperative Determine ability to continue of operations a of at-risk cooperative 	16 to 30	
	Take Informal Meassures	<ul style="list-style-type: none"> COSSEC Management to determine which informal measure to be taken (solicitation for action plans, follow up action plans, written warnings, supervisory visits) Inform at-risk cooperative's BOD of informal measure taken Cooperative to comply with informal measure taken 	31 to 35	
	Determine Formal Measure to be taken	<ul style="list-style-type: none"> COSSEC Management to determine if Cease and Desist Order will be Issued or if cooperative will automatically be placed on receivership 	36 to 40	
Corrective actions	Issue Cease and Desist Order	<ul style="list-style-type: none"> COSSEC management determines Cease and Desist Order is required Administrative hearing with he COSSEC official examiner, the COSSEC lawyer and/or management, and the insolvent cooperative's lawyer and/or management Official examiner to issue a final report to determine if at-risk cooperative will be placed on receivership 	41 to 45 46 to 55 56 to 70	
	Phase	Goal	Milestone	Day (1-90)
	Corrective actions (contd...)	Issue Order of Provisional Administration under Receivership	<ul style="list-style-type: none"> COSSEC Examiner to Issue preliminary Rehabilitation report 	71 to 80
Generate Rehabilitation Plan		<ul style="list-style-type: none"> COSSEC Examiner and COSSEC Management to generate final Rehabilitation plan for at-risk Cooperative 	81 to 85	
		<ul style="list-style-type: none"> Generate final rehabilitation plan 	86 to 90	
		<ul style="list-style-type: none"> Inform at-risk cooperative of final resolution (P&A, Involuntary Merger, Liquidation) 		
Rehabilitation plan key steps (Liquidation, P&A, Involuntary Merger, or Injection Plan)		<ul style="list-style-type: none"> Conduct due diligence on intervened cooperative Conduct liquidation basis financial audit Identify Coop's & Non-Coop's Partners P&A Transaction Data Room for Evaluated Partners Due dilligence and bidders process Identify possible acquisition partners Evaluation of proposals COSSEC to notify final decision to FOMB and AAFAF Conduct transaction 	91 to 120	

Following the typical resolution process above, COSSEC must take appropriate interventions for all Priority 1 cooperatives within 24 months under the following calendar:

EXHIBIT 14: 24-MONTH INTERVENTION CALENDAR

Stage	Milestone	Date
First round of remedial actions (6-months)	▪ COSSEC to initiate corrective action process for cooperatives	Executed
	▪ COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	Executed
	▪ COSSEC to have end-of-round debrief meeting with FOMB team to report progress on cooperatives under corrective action and outline lessons learned	Executed
Second round of remedial actions (6-months)	▪ COSSEC to continue with corrective action process for cooperatives, applying lessons learned from first round of remedial actions	January-June 2022
	▪ COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	March 2022
	▪ COSSEC to have mid-point session with FOMB team to report progress for cooperatives under corrective action, outline lessons learned, and to present plan for last 12-months	June 2022
Third round of remedial actions (6-months)	▪ COSSEC to continue with process for cooperatives under corrective action, applying lessons learned from first round of remedial actions	July-December 2022
	▪ COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	September 2022
	▪ COSSEC to have end-of-round debrief meeting with FOMB team to report cooperatives under corrective action intervention progress and outline lessons learned	December 2022
Last round of remedial actions (6-months)	▪ COSSEC to continue with cooperatives under corrective action, following corrective action process and applying lessons learned from first round of remedial actions	January-June 2023
	▪ COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	March 2023
	▪ COSSEC to have a closing meeting with FOMB team to report on all cooperative corrective action processes	June 2023

Focusing supervision resources on financial cooperatives

Under the current structure, COSSEC is the regulating entity for both financial (109) and certain non-financial (153) cooperatives in the Commonwealth. Financial cooperatives fall under the legal framework of Act 255-2002, and non-financial cooperatives are regulated under Act 239-2004. Non-financial cooperatives do not contribute to COSSEC’s resources yet consume some amount of COSSEC’s resources that could be allocated to addressing the issues outlined in this Fiscal Plan related to financial cooperatives.

This structure thus impacts COSSEC’s ability to comply with the COSSEC Fiscal Plan by:

- Increasing COSSEC examiners’ workload
- Limiting COSSEC’s capabilities of examination and receivership of financial cooperatives
- Creating additional delays in receiverships of non-financial cooperatives and COSSEC’s corrective actions
- Increasing the long-term cost of the COSSEC Insurance Fund because of these delayed corrective actions.

COSSEC examiners' workload relative to financial cooperatives decreased from the 2020 CCFP to the 2021. CCFP Although the number of examiners (adjusted to recruitment and resignations) remains intact (36 examiners), the number of examined financial cooperatives decreased to 109 cooperatives. As result, the ratio of financial cooperatives to examiner was reduced from 3.1 to 3.0. The ratio of non-financial cooperatives to examiner and total cooperatives to examiner (financial and non-financial) remains the same, at 4.3 and 7.3 respectively, based on the available information.

EXHIBIT 15: COOPERATIVES & EXAMINERS

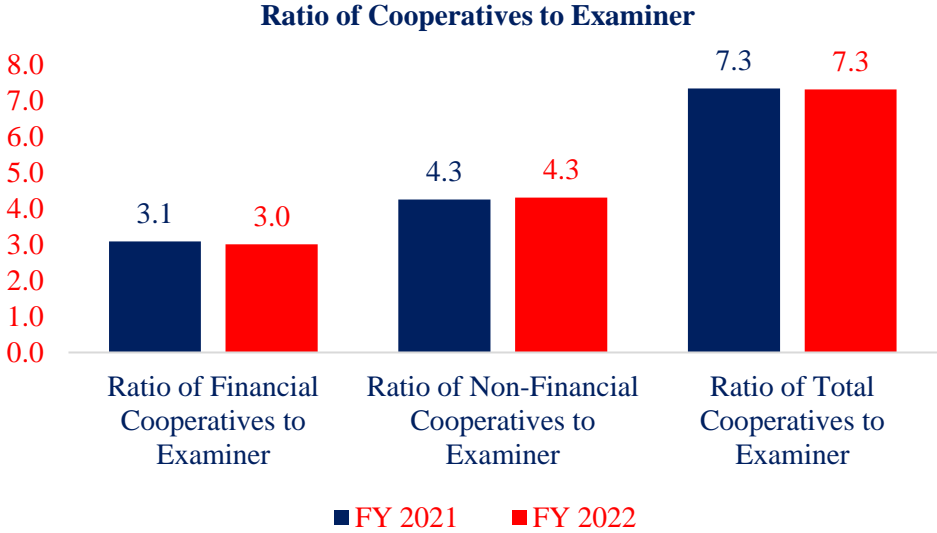
	FY 2021	FY 2022
Non-Financial Cooperatives	153	153
Financial Cooperatives	111	109
Total Cooperatives	264	262
COSSEC Examiners	36	36
Ratio of Financial Cooperatives to Examiner	3.1	3.0
Ratio of Non-Financial Cooperatives to Examiner	4.3	4.3
Ratio of Total Cooperatives to Examiner	7.3	7.3

Source: CCFP 2021 & COSSEC Reporting Requirements.

On January 2022, legislation was presented in the Senate and the House of Representatives to transfer the regulatory power of non-financial cooperatives to the Cooperative Development Commission (“CDC”). The Government and COSSEC should continue to promote the prompt enactment of such legislation. To be convergent with the legislation process, **the Oversight Board recommends that the COSSEC FY 2023 budget set aside funds to pay for COSSEC employees working at the CDC to complete the transferring of non-financial cooperatives to the CDC. For the FY 2024 budget, the Oversight Board recommends that COSSEC and AAFAF work together to provide recurring funding to cover the expenses of the transferred employees.**

In addition to addressing COSSEC’s employees working at the CDC, COSSEC should explore the benefits of Act 8-2017, known as the “Single Employer Act,” to promote the transfer of human resources from other government entities to CDC who may assist the latter in managing the expected new workload. COSSEC should also take advantage of the collaboration agreement between the University of Puerto Rico and the Commonwealth for seminars and training purposes, which could allow University of Puerto Rico Cooperative Institute students to gain practical skills and relevant training at CDC via the “on-the-job training program”.

EXHIBIT 16: RATIO OF COOPERATIVES TO EXAMINER



Chapter 5. Measures to advance digital and technology capabilities of the cooperative system

Technology-enabling the Co-op system to better reach underserved communities

The cooperative system is fundamental to the economy of Puerto Rico, and its relevance to members and depositors goes beyond the restoration of capital and risk measures. The cooperatives’ strategy should focus on effectively serving members in the next 5-10 years, while keeping an eye over the long term on members’ trends, the competitive environment, changes in regulation, and the growing role that digital and advanced analytics play in the industry.

The close relationship that cooperatives have with their members is one of their key differentiators, as it reinforces affinity by establishing strong ties to community activities. Cooperatives are also financial entities that provide market-leading value to the underbanked and unbanked segments with a tailored approach that improves their financial well-being. This should continue to be central for the cooperative system and its performance in the future, particularly given that future success will require banks and financial entities to develop an increasingly differentiated strategic positioning.

It is important, however, not to lose sight of the pace at which financial institutions are embedding technology into their processes and operations. Cooperatives should adopt a smart, defensive strategy in terms of digital options in order to survive and thrive in the mid- and long-term and to be able to effectively compete with federal credit unions and commercial banks operating in the local financial market.

Today, financial entities around the world are leveraging technology and digital tools to lower the cost-to-serve, develop alternative risk models, unlock ubiquitous access, and rapidly and cost-

effectively develop tailored products for clients. Collectively, these actions improve both members' experience and the financial health of banking institutions. Going forward, COSSEC should evaluate how it and the cooperative system can update and adopt technology and digital tools.

The widespread use of smartphones, coupled with the reduced costs of technology, make digital banking solutions accessible even to smaller financial entities around the world. In 2020, Puerto Rico had 71% internet penetration (or ~2.6 million users).¹⁸ At the same time, there are significant economies of scale that derive from the use of technology: while the cost of a branch network grows in-line with customer growth, the cost of developing and adopting technological solutions does not grow proportionally to the member base. That reduced cost allows banks to scale up more quickly without incurring additional costs. These solutions also give financial entities a competitive advantage over their competitors.

In order to prevent the cooperative system from falling behind, and to help it better serve its clients, COSSEC should adopt guidelines and incentives to assist cooperatives in the process of implementing an integral technological strategy that includes innovative approaches to transform customer journeys (e.g., through multi-channel products and services) and internal operational processes (e.g., to digitize end-to-end processes, better utilize data and analytics to improve members outcomes). Adopting these leading practices will benefit the broad base of cooperative members, but also boost financial performance among cooperatives to improve their long-term sustainability.

Census of Digital and Technology Capabilities

The results of the census of digital and technology capabilities required by the 2021 CCFP reflect that in the 12 parameters of digital and technological capabilities, the availability percentage fluctuates from 78% to 4% with an average of 47%. For example, 78% of financial cooperatives have available a system of internet banking, but the option of changing ATM PIN (“personal identification number”) is available in only 4%. Other extreme values include the fact that 74% of the financial cooperatives provide the option of electronically transferring funds, while only 15% provide the option to activate ATMs.

To continue the process of digital and technology advance of the cooperative system, **the COSSEC must submit a post-census report on digital and technology capabilities within 220 days after the certification of this Fiscal Plan 2022** with recommendations of “cost efficient actions” to update technologically those cooperatives with lower percentages of digital and technology capabilities and to narrow the gap with the rest of the cooperatives.

The Issue of Cyber Risk

Along with digital and technology capabilities, the cooperative system needs to be aware of the volume and sophistication of cyber threat as reported by the Federal Financial Institutions

¹⁸ World Bank. (2021). *Share of the population using the Internet, 2019*. Retrieve from: <https://ourworldindata.org/grapher/share-of-individuals-using-the-internet>

Examination Council¹⁹ (FFIEC). According to the FFIEC, financial institutions need to be prepared to detect their risk and embark on an assessment process to mitigate the prospects of a “cyber risk” and the potential financial and reputational effect and increasing cost due to forensic investigations. A cyber-attack could have a detrimental financial effect on financial institutions such as cooperatives, and such an attack would thwart the 2022 CCFP’s objective of building a safe and resilient cooperative system aligned with NCUA and FDIC global best practices. According to the Federal Reserve Bank of New York,²⁰ a cyber-attack could generate losses, impair liquidity and solvency, and hamper the ability to service clients. A cyber-attack could also create runs or withdrawals of funds in sections of the financial institution unaffected by the attack.

In this regard, the level of “cybersecurity” or a “process of protecting information by preventing, detecting, and responding to attacks” according to the National Institute of Standards and Technology²¹ (NIST), is a most important priority within financial cooperatives. FFIEC includes, as cybersecurity control parameters to detect anomalies within the network, assessment tools such as vulnerability and penetration testing. Most recently, the U.S. Department of Homeland Security’s Cybersecurity and Infrastructure Security Agency (CISA) and NCUA²² alerted that actual geopolitical event concerning the invasion of Ukraine by the Russian Federation could increase cyber threats to financial institutions as have already been suffered by Ukrainian public and private entities. To that end, **COSSEC must submit a status report of the level of cybersecurity among financial cooperatives within 220 days after the certification of this 2022 Fiscal Plan** with the following:

- Number of financial cooperatives that routinely perform vulnerability and penetration testing
- Recommendations of “cost efficient course of actions” for those cooperatives that lack adequate testing mechanisms to prevent cyber-attacks.

¹⁹ Federal Financial Institutions Examination Council. (2017). *Cybersecurity Assessment Tool*. Retrieve from: https://www.ffiec.gov/pdf/cybersecurity/FFIEC_CAT_May_2017.pdf

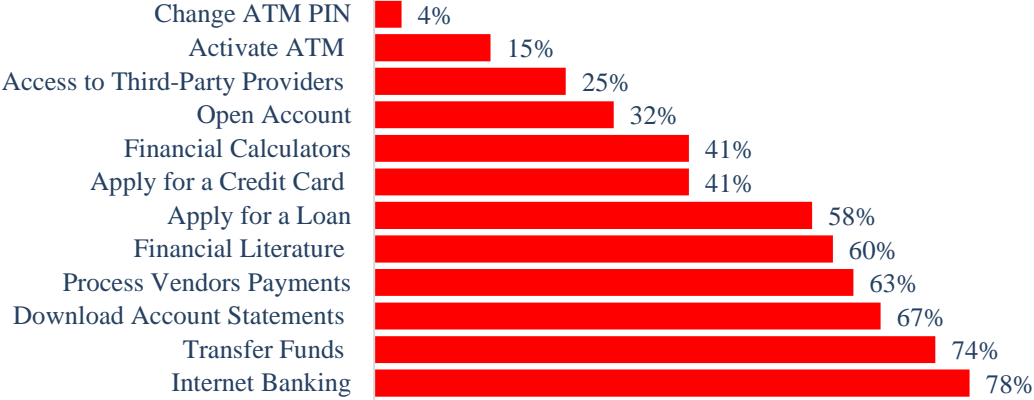
²⁰ Federal Reserve Bank of New York. (2021). *Cyber Risk and the U.S. Financial System: A Pre-Mortem Analysis* Retrieve from: https://www.newyorkfed.org/research/staff_reports/sr909

²¹ National Institute of Standards and Technology. (2018). *Framework for Improving Critical Infrastructure Cybersecurity Version 1.1*. Retrieve from: <https://www.nist.gov/publications/framework-improving-critical-infrastructure-cybersecurity-version-1-1>

²² National Credit Union Administration. (2022). *Current Geopolitical Events Increase Likelihood of Imminent Cyberattacks on Financial Institutions*. Retrieve from: <https://www.ncua.gov/regulation-supervision/regulatory-compliance-resources/cybersecurity-resources>

EXHIBIT 17: RESULTS OF THE CENSUS OF COOPERATIVES DIGITAL AND TECHNOLOGICAL CAPABILITIES

Percentage of Availability of Digital and Technological Capabilities Among Financial Cooperatives



Chapter 6. Measures to improve contingency planning

COSSEC should prepare for all contingencies. COSSEC maintains an insurance fund to provide the resources needed to address troubled and at-risk cooperatives. The most direct way to fund these interventions is to sell a portion of the COSSEC investment fund (consisting of bond positions with unrealized gains that will not have a negative impact on COSSEC revenues and budget), which exists for these purposes. However, there are alternatives that COSSEC must explore to avoid or reduce the need to sell down the portfolio when additional resources are needed.

Short-term financing

Short-term financing solutions are viable to address the more immediate cooperative liquidity needs. These needs could be a result of the cooperatives’ current financial standing, the effect that COVID-19 and the associated loan moratorium will have upon cooperatives’ capital, and/or the mitigation measures taken for at-risk cooperatives. These measures are not a long-term solution; they can help buy time while more permanent reforms are implemented.

COSSEC’s Insurance Fund (portfolio)

COSSEC’s insurance fund exists, in part, to provide the resources needed to fund COSSEC’s final resolutions for cooperatives. This measure is allowed under Act 114-2001 and needs to follow COSSEC’s Investment Policy. Potential amounts that could be tapped into include MBS \$49.0, US corporate bonds \$102.8, US Treasury bonds \$5.2, US Agencies bonds \$59.4, & US municipal bonds \$120.4.

If COSSEC were to sell the part of its insurance fund that has unrealized profits, it would not incur interest expense (unlike other measures, such as a credit line).

Credit from financial institutions

Another potential alternative permissible under this 2022 CCFP is to access a line of credit from financial institutions willing to lend to COSSEC, as per section 29 of Act 114-2001, “Loans and Issue of Debt Instruments and other Securities.” The rationale behind this short-term financing measure is to give COSSEC the ability to spend and invest cash flows in the next 1-2 years to attend to current needs and repay in 1-15 years. This approach would require that private financial institutions be willing to lend to COSSEC on reasonable terms.

As part of its routine contingency planning, **the Government and COSSEC must, within 60 days after certification of this 2022 Fiscal Plan, submit a plan showing how they would ensure adequate funding for COSSEC** under the scenarios explored in Chapter 3 with actual sources of adequate funding of the reserve for expected losses with scenarios of annual payment of COSSEC assuming 100%, 75% and 50% of the loss of insolvent cooperatives. The funding gap will be COSSEC’s reserve for expected losses minus total losses (accumulated losses plus investment losses) of cooperatives.

Chapter 7. Measures to build COSSEC’s resources

In the longer term, COSSEC must find realistic ways to make the cooperative movement sustainable. Following the process of sales of assets and liabilities, liquidation or merging of insolvent cooperatives, the resources of the COSSEC Insurance Fund will be depleted and the insurance premiums collected by COSSEC also will be lower due to a reduced number of insured cooperatives in the co-op system. Increasing insurance premiums may not be an option in the short term, as cooperatives may not be able to withstand the resulting increased financial burden.

However, in the future, COSSEC could increase premiums to obtain incremental annual funding. Increasing premiums within the cooperative system to rebuild COSSEC’s financial resources will be necessary over the long term.

To increase premiums in the long term, COSSEC must conduct additional analyses on the amount of insurance premiums that would be commensurate with the income-generating capacity of the cooperative system and with the risks that are being insured. To do so, COSSEC must benchmark against other similar systems and supervisory bodies (e.g. NCUA) to best determine the right level of premiums in the long term.

For example, NCUA uses the equity ratio of the National Credit Union Share Insurance Fund (“share insurance fund”) calculated as a ratio of retained earnings and contributed capital to the insured shares as a parameter for insurance premium increases.²³ When the equity ratio decreases below a certain level, the NCUA Board requires a premium charge to restore the equity ratio.

²³ Office of the Law Revision Counsel. (2022). *United States Code Title 12 Banks and Banking* Retrieve from: <https://uscode.house.gov/browse/prelim@title12>

Nevertheless, a pro rata distribution is declared to insured credit unions when the equity ratio exceeds a normal operating level.

Current insurance premiums rates for the shares and deposits insurance program to be paid by local cooperatives are based on a model estimating financial risk and COSSEC's operational expenses. COSSEC actuarial studies must consider incorporating additional metrics, such as a minimum benchmark equity ratio that could be considered as a rationale for increasing premiums when it is reached and a pro rata distribution when the ratio surpasses a specified percentage.

Based on the previous analysis, **within 120 days after certification of this 2022 Fiscal Plan, COSSEC must submit a feasibility study outlining the extent to which premiums can be increased to build longer-term COSSEC capital and provide recommendations toward the implementation of NCUA equity ratio for insurance premiums increase or pro rata distribution.** Also, COSSEC must submit a copy of the following reports required by Act 114-2001:

- Actuarial study for the determination of COSSEC shares and deposits insurance premium rates (required by Act 114-2001).
- Actuarial study of the indicated loss reserve (required by Act 114-2001).

Chapter 8. Measures to optimize COSSEC's organizational structure

Today, the regulatory and financial functions of COSSEC operate as a single organism. Optimization of COSSEC's organizational structure must focus on adopting a design that allows COSSEC to accomplish its present mission and comply with future goals. This includes decentralizing functions to promote specialization and improve managerial performance.

Looking to make operations more efficient and to help staff specialize in either function, COSSEC must separate the managerial functions of the administrative structure from the financial structure of the current COSSEC legal entity. This would replicate the basic organizational structure of NCUA.

Operations that fall under the financial function of COSSEC must include (but not be limited to) the following:

- Operating COSSEC's Insurance Fund, insuring COSSEC member's deposits up to \$250,000 each.
- Setting up an Investment Board and team that manages the endowment and consists of investment, operations, and administrative professionals.
- Setting up a central liquidity facility (similar to the NCUA liquidity facility) with the goal of improving the general financial stability of the cooperative system by providing short-term liquidity to cooperatives with securities pledged as collateral. Its management would be overseen by the COSSEC Board.

Similarly, operations of the regulatory function of COSSEC should include (but not be limited to) the following:

- Overseeing cooperatives' financial standing and accounting, and ensuring they are operating in a sound and sustainable way.
- Managing losses associated with at-risk cooperatives, as well as intervention and rehabilitation programs associated with such cooperatives.
- Training examiners and staff, to ensure that they will continue to oversee cooperatives using the highest standards.

The operations side of the COSSEC administrative structure should be headed by COSSEC's executive director.

To implement these internal re-organization measures, the Government must present legislation to amend Law 114-2001. Upon approval, employees will need to be divided between the COSSEC Insurance Fund and COSSEC as the Regulator. These measures must take effect no later than December 2022.

With these longer-term measures, COSSEC will develop a more specialized, robust structure to be better able to serve cooperatives and their members in the most efficient, transparent way.

Chapter 9. Approach to organizational methods

Nearly three years ago, the Government of Puerto Rico committed to reform COSSEC to ensure its safety and soundness. Solvency and liquidity concerns turned this reform into a fundamental one that would ensure that cooperatives fulfill their role in municipalities and local communities. Notwithstanding the relevance of this reform, very little has happened in the past three years, and the pace of interventions for cooperatives with financial concerns has been slow.

Transformation Management Office

With this in mind, this Fiscal Plan outlines a series of critical measures that must be implemented urgently. Successful system reforms go together with a strong and agile Transformation Management Office ("TMO") that oversees and follows up with all initiatives for cooperatives that underwent or will undergo an intervention. Five members of COSSEC with +10 years of experience who have worked in cooperative receivership processes should join the COSSEC TMO to coordinate, support and track the intervention processes. The TMO's role is to provide enough support and guidance to the examiners, lawyers, and information system staff responsible for cooperative interventions.

Four core transformation functions of a TMO will ensure that the TMO's mandate is effectively carried out:

- *Strategy*: focus on strategic planning process of cooperative interventions, leading key initiatives within each phase of intervention, and managing stakeholders.

- *Change management*: focus on overseeing, planning, executing, and implementing interventions and assessing human capital needs of each cooperative (examiners, lawyers, and supervisors of information system).
- *Delivery management*: focus on tracking interventions and ensuring they occur within defined timelines and budgets, resolving issues and conflicts that might arise from cooperative interventions.
- *Project management*: focus on tracking intervention KPIs and report progress updates.

Each of these functions must represent a role assigned to a COSSEC member. Moreover, the head of the TMO must be assigned to ensure effective communication, aggregate data, and support initiative owners. The TMO was created in FY21, and FOMB expects that it will continue the transformation as outlined in this Certified Fiscal Plan. The Government must ensure that a qualified individual is appointed to lead the TMO and, if no candidates are found within COSSEC, must lead the process to identify someone. **The Government and COSSEC must, within 120 days after certification of this 2022 Fiscal Plan, submit an Updated Report of the Transformation Management Office.**

The TMO has been distributing the Examination Area personnel to address undercapitalized cooperatives in accordance with prior CCFPs and has met with personnel working on cooperatives under COSSEC receivership to discuss a monthly report. The TMO has also recommended several administrative decisions to request capitalization plans from insolvent and undercapitalized cooperatives.

In general terms, COSSEC has complied with the prior CCFPs' objectives for the TMO. Nevertheless, COSSEC should avoid turning the TMO into a larger managerial structure within COSSEC than is described in the CCFPs, to avoid potential duplication within the COSSEC Examination Area.

On November 9, 2020,²⁴ the Oversight Board opposed COSSEC' decision to seek capitalization plans from insolvent cooperatives, since most of the insolvent cooperatives have been in either priority 1 or priority 2 status since 2017, according to COSSEC's Actuarial Reports. COSSEC's decision entailed the:

- Continued delay of the CCFPs milestones.
- Compromised the financial resources of solvent cooperatives participating in bidding processes.
- Had a potential higher cost to the COSSEC Insurance Fund (due to further deterioration of the assets of undercapitalized cooperatives) without necessarily rehabilitating insolvent cooperatives.

²⁴ The Financial Oversight and Management Board for Puerto Rico. (2020, November). Proposed Capitalization Plan to Insolvent Cooperatives. Retrieve from: <https://oversightboard.pr.gov/about-us/>

Within 120 days after certification of this 2022 Fiscal Plan, COSSEC and its TMO must submit a status report of the capitalization plans for insolvent and undercapitalized cooperatives reflecting their respective likelihood (possibility) of rehabilitation.

Human capital and staffing

Cooperative intervention processes require the participation of examiners, supervisors of information systems, and lawyers. Depending on the size of each at-risk cooperative, the intervention process will have different staffing needs. Each of these roles has distinct responsibilities during phase 2 and 3 of intervention.

Furthermore, to efficiently reform the system, COSSEC staff should intervene in the cooperatives in the most efficient way possible. To intervene efficiently, there should be certain adjustments to current assignments of human capital:

- COSSEC lawyers are currently on loan to other government agencies. Before COSSEC considers adding any other lawyers to its team, it should recall those loaned lawyers to COSSEC in order to permanently address critical needs or should transfer them out of COSSEC so that their positions at COSSEC become available.
- Some examiners with receivership experience are currently working on non-financial cooperatives (cooperatives under Act 239-2004). These examiners should be assigned to work only on financially at-risk cooperatives (cooperatives under Act 255-2002).
- Today, not all COSSEC Examiners occupy their role within the Examination Area (they occupy other vacant positions within COSSEC). These employees should return to their original roles, to ensure that the Examination Area activities are fulfilled.
- Recently certified examiners should work together with, and learn from, more experienced examiners during the intervention process.

As previously mentioned, COSSEC's actual workforce of 36 examiners to examine 109 financial cooperatives suggests a cooperative to examiners' ratio of 3.0. When 153 non-financial cooperatives are considered for a total of 262 cooperatives, the cooperatives to examiners ratio is 7.3. The increase of cooperatives to examiner ratio from 3.0 to 7.3 (143%), when considering non-financial cooperatives, represents an extraordinary workload for COSSEC's Examination Area that includes not only the examiners, but supervisors and Assistants to Vice-President. Excessive workload could delay the implementation of the milestone to complete intervention and final resolution of insolvent cooperatives within 24 months.

EXHIBIT 18: INTERVENTIONS AND HUMAN CAPITAL NEEDS

COSSEC human capital needs per cooperative under corrective actions

Context		Approach						
<ul style="list-style-type: none"> Cooperatives that will undergo corrective actions within the next 24 months have been grouped into 3 categories—small, medium and large—based on size of their assets 	Cooperative asset size		<ul style="list-style-type: none"> Corrective action processes staff needs and required dedication have been defined based on cooperative size and phase of corrective action process 					
		Assets (\$)	Examiners		IT		Lawyers	
	Small	<20M	Phase 2	Phase 3	Phase 2	Phase 3	Phase 2	Phase 3
	Medium	20M-60M	2	2	1	1	1	0
Large	>60M	3	3	1	1	1	0	
Total		4	4	1	1	1	0	
				<ul style="list-style-type: none"> Dedication requirements vary for each position <ul style="list-style-type: none"> Examiners are fully dedicated to one cooperative System can be dedicated to two cooperatives (at any given point in time) Lawyers can be dedicated to three cooperatives (at any given point in time) 				

If additional training is required to guarantee the preparedness of COSSEC’s team, collaboration with NCUA should be sought for training purposes. Specifically, training for COSSEC examiners is necessary in the following areas: (i) audits, (ii) risk determination, (iii) fraud, (iv) financial analysis, (v) due diligence, (vi) portfolio valuation & (vii) key ratio computation.

Building COSSEC examiners’ skills and capacity commensurate with the challenges ahead

Building COSSEC examiners’ skills and capacity commensurate with the challenges ahead is key to successfully reforming the system. COSSEC must ensure that it has sufficient and well-trained staff to promptly resolve and implement a final resolution for troubled cooperatives, enhance its approach to supervision, and establish risk-based controls over cooperatives’ operations. Furthermore, COSSEC must have specialized staff members who are dedicated to addressing at-risk cooperatives, as opposed to having staff members who are on loan to other government offices or institutions.

Compliance with Government-wide policy on employer-sponsored health coverage

Health insurance is a core benefit provided to all government employees. However, the degree of coverage varies widely across government agencies, with some employees receiving superior coverage compared to their peers. To ensure fairness and reduce expenditures, **COSSEC must implement the Government’s five-year-old policy to standardize employer health insurance contributions so that all Commonwealth agencies contribute \$125 per employee per month, or \$1,500 per year, while also maintaining current employer contribution levels for those employees and dependents with pre-existing conditions (as per Law 26- 2017).**

Implementation Milestones

The required implementation milestones are summarized in Exhibit 19 below.

EXHIBIT 19: SUMMARY OF MILESTONES

Theme	Area of reform	Milestone	Deadline
Milestones required to improve governance, oversight and supervision	Governance	COSSEC submits legislation for board of director's reform	Ordinary Session
		Implement Board of Directors changes	After legislation becomes a law
	Transparency in accounting	COSSEC submits legislation for RAP to GAAP Accounting	Ordinary Session
		Widespread adoption of GAAP accounting	June 2025
	Supervisory interventions	COSSEC submits legislation to repeal article 11.02 (d) of Act 220-2015 to allow for interventions of insolvent cooperatives	Ordinary Session
		Complete interventions of insolvent cooperatives over the next 24 months	June 2023
		Complete interventions of insolvent cooperatives over the next 24 months	within 30 days of certification of this 2020 Fiscal Plan
	Non-financial cooperatives	COSSEC submits legislation submit legislation to transfer of non-financial cooperatives to the CDC	Executed
		COSSEC transfers non-financial cooperatives to CDC	December 2023
	Milestones required to advance digital and technology capabilities	Digital and technology capabilities	Updated analysis of the opportunities to improve the cooperative system based on a census of the 111 cooperatives
Post Census of Digital and Technology Capabilities Report			December 2022
Status Report of the Level of Cybersecurity of Financial Cooperatives			December 2022
Milestones required to improve contingency planning	Financing	Plan showing how it would ensure adequate funding for COSSEC	Executed
Updated plan showing how it would ensure adequate funding for COSSEC		July 2022	
Milestones required to build COSSEC resources	COSSEC Resources	The Government must submit a feasibility study to the Oversight Board outlining the extent to which premiums can be increased to build longer-term COSSEC capital and analysis of considering NCUA equity ratio for insurance premiums increase or pro rata distribution.	September 2022
Milestones required to optimize COSSEC organization al structure	Organizational structure	Government must present legislation to amend Law 114-2001	Ordinary Session
		The internal division of employees needs to take place between COSSEC Insurance Fund and COSSEC as the Regulator	After legislation becomes a law
Milestones Required to TMO and Health Coverage	TMO	Establishment of the Transformation Management Office	Executed
		Updated Transformation Management Office Report	September 2022
	Health coverage	COSSEC and the Government must implement the Government's policy to standardize employer health insurance contributions so that all Commonwealth agencies contribute \$125 per employee per month, or \$1,500 per year	August 2022

Part III: Financial projections and required reporting

Chapter 10. COSSEC 5 Year Financial Projections

EXHIBIT 20: FY22-FY27 EXPENSE SUMMARY

COSSEC Expenditures Projections

000s		FY2022	FY2023	FY2024	FY2025	FY2026	FY2027
	Inflation	3.8%	2.7%	1.7%	1.6%	1.5%	1.5%
Pre-measures expenditures (baseline)	COSSEC Payroll (w/o employees' addition)	\$6,226	\$8,412	\$8,668	\$8,845	\$9,009	\$9,177
	COSSEC OPEX	\$3,506	\$4,084	\$3,658	\$3,479	\$3,310	\$3,385
	Total pre-measures expenditures¹	\$9,732	\$12,496	\$12,326	\$12,324	\$12,319	\$12,562
OPEX measures	Total OPEX measures	\$0	\$0	\$0	\$0	\$0	\$0
Payroll measures	Total Payroll measures	(\$47)	\$0	\$0	\$0	\$0	\$0
Budgetary Reserves	Milestone Reserve	\$393	\$400	\$400	\$400	\$400	\$400
Post-measures expenditures	COSSEC post-measures expenditures	\$10,078	\$12,896	\$12,726	\$12,724	\$12,719	\$12,962

EXHIBIT 21: COSSEC 5-YEAR PROJECTIONS

COSSEC 5-year projections

000s		FY2022	FY2023	FY2024	FY2025	FY2026	FY2027
Revenues	Regular Premiums ¹	\$28,468	\$28,700	\$26,000	\$26,000	\$26,000	\$26,000
	Interest income	\$10,726	\$10,477	\$10,800	\$10,214	\$11,003	\$10,500
	Other revenue	\$8	\$0	\$0	\$0	\$0	\$0
	Total operating revenues²	\$39,202	\$39,177	\$36,800	\$36,214	\$37,003	\$36,500
Post-measures expenditures	Post-measures expenditures³	\$10,078	\$12,896	\$12,726	\$12,724	\$12,719	\$12,962
Net	Net	\$29,124	\$26,281	\$24,074	\$23,490	\$24,284	\$23,538

1. Premiums are subject to change contingent on the premium increase feasibility study to be conducted by COSSEC.

2. Net revenues exclude change in investment value, realized gain or loss on investment, and bond premium amortization.

Expense measures

No measures were required in FY21. In FY22, COSSEC must implement the following measures (per annum amounts, beginning in FY22)

- 1) Milestone reserve

The 2022 COSSEC Fiscal Plan recognizes the significant effort needed to make progress on the requirements of this Fiscal Plan. This new Fiscal Plan includes approximately ~\$400,000 in funds that are held under abeyance and will be released subject to the completion of the milestones.

Revenue measures

This Fiscal Plan includes a requirement to conduct a feasibility study on options to increase revenues through premium increases. Future revenue measures will be required based on the findings of this study.

Chapter 11. Required reporting

COSSEC must report the following items to the FOMB:

EXHIBIT 22: COSSEC REPORTING REQUIREMENTS

Area	Reporting Requirement	Closing the 1st reporting period	Cadence for FOMB Reporting	Cadence for Public Reporting	Reporting Requirement Source
Budget reporting	Monthly Budget to Actual Report - Including Revenues, provision for losses, changes to investment value, and premium bond amortization	1-Jul	Monthly	Monthly	Budget
	COSSEC Liquidity vs Budget	1-Jul	Monthly	N/A	Budget
	Revenue forecast	1-Jul	Monthly	N/A	Budget
COSSEC Governance reporting	BOD meetings updates	1-Jul	Monthly	N/A	Fiscal Plan
	Changes to BOD members update	1-Jul	Monthly	Monthly	Fiscal Plan
Cooperatives' reporting	Insolvent cooperatives interventions	1-Jul	Quarterly	Quarterly	Fiscal Plan
	Cooperatives Receivership update	1-Jul	Monthly	Monthly	Fiscal Plan
	Cooperatives liquidity report	1-Jul	Monthly	N/A	Fiscal Plan
	Cooperatives cross-deposit report	1-Jul	Quarterly	N/A	Fiscal Plan
	Cooperatives cash flow report	1-Jul	Monthly	N/A	Fiscal Plan
	Changes to cooperatives' Executive Presidents	1-Jul	Quarterly	Quarterly	Fiscal Plan
	All Cooperatives' Call Report	1-Jul	Quarterly	Quarterly	Fiscal Plan
Updated Triage Report for Priority 1 and 2 Cooperatives	1-Jul	Quarterly	N/A	Fiscal Plan	

Insurance Fund Funding reporting	Insurance Fund Liquidity	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio average yield to maturity	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio average coupon	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio modified duration	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio effective duration	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio average credit rating (S&Ps, Moodys, and Fitch)	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio Interest Cash Flow	1-Jul	Monthly	N/A	Fiscal Plan
	Investment Portfolio Principal Cash Flow	1-Jul	Monthly	N/A	Fiscal Plan
Changes to regulation reporting	Changes to governance	1-Jul	Monthly	Monthly	Fiscal Plan
	RAP accounting to GAAP accounting Transition	1-Jul	Monthly	Monthly	Fiscal Plan
	Changes to P&A participants (ammendment of section 7.02 of Act 255-2002)	1-Jul	Monthly	Monthly	-
Stakeholder engagement reporting	Meetings with Liga de Cooperativas	1-Jul	Monthly	Monthly	Fiscal Plan
	Meetings with G25	1-Jul	Monthly	Monthly	Fiscal Plan
	Meetings with Alianza de Cooperativas	1-Jul	Monthly	Monthly	Fiscal Plan
	Meetings between COSSEC and AAFAF	1-Jul	Weekly	Weekly	Fiscal Plan
Certifications, Trainings and Others reporting	COSSEC Employee hires	1-Jul	Monthly	Monthly	Fiscal Plan
	COSSEC Examiners Training	1-Jul	Quarterly	Quarterly	Fiscal Plan
	COSSEC Payroll and Headcount	1-Jul	Monthly	Monthly	Fiscal Plan
	COSSEC KPIs	1-Jul	Monthly	Monthly	Fiscal Plan

In addition, any interventions in cooperatives with financial concerns should be consistent with this 2022 CCFP and subsequently certified budget(s). Any applicable legal agreements must be submitted for Oversight Board approval consistent with the Board’s contract review policy pursuant to section 204(b)(2) of PROMESA.

The Oversight Board generally considers capital injection transactions to be inconsistent with this 2022 CCFP because they are typically not the option with the lowest long-term cost to the Insurance Fund.

Chapter 12. Conclusion

The 2022 CCFP is focused on maintaining the financial stability of COSSEC and the cooperative system in Puerto Rico, ensuring that its ~1M members are served in the best possible way. The starting point of this plan requires reforms to the cooperative system on three main axes: overall changes in governance, adapting of accounting standards, and adoption of stabilization measures.

The aftermath of the COVID-19 crisis, the 4-month loan moratorium, elevated levels of inflation in the United States, Russia’s attack on Ukraine, and the decline of the US economy GDP will pose heightened challenges for some cooperatives. The “new normal” will also set the stage for cooperatives to serve communities of Puerto Rico in new dimensions. The 2022 CCFP lays out a series of reforms that will allow COSSEC to address the cooperatives’ most pressing needs, while paving the way for the cooperative system in the future.

Implementation of measures is the most critical step in reforming COSSEC and ensuring the long-term stability and soundness of the cooperative system. Although there has been some progress in the reforms in implementing the measures required by the 2020 and 2021 CCFPs, including improving supervisory interventions of insolvent cooperatives, deepening engagement with cooperatives' stakeholders, more proactively monitoring the systemic risk in the cooperative system by promoting routine exchange of reports and financial metrics, and improving the management of COSSEC's budget; more is needed.

A clear vision for the future of the cooperative system is required with an understanding of how to modernize the system and ensure it does not fall behind other financial services in Puerto Rico and in the U.S. mainland. With sustained dedication to implement the 2022 CCFP and the determination to protect COSSEC's Insurance Fund, provide services to depositors and build a safe and resilient cooperative system aligned with global regulatory best practices, e.g., those employed by U.S. federal regulators such as the NCUA and the FDIC, COSSEC's future will be unstoppable.

Chapter 13. Supporting information

Appendix

Appendix 1: Case Studies on restoring financial system

When dealing with banking systems in distress, there are typically three main components to a solution. The first is transparency in accounting, which allows stakeholders to understand the financial resources that are required to stabilize the system and helps articulate reforms for the long-term benefit of the financial system that are realistic and based on an accurate picture of the problem. Such an initiative requires the relevant actors to gather sufficient and clear data so as to gain a full picture of the financial resources that are needed. The second component is adopting stabilization measures to bolster confidence in the system and prevent a run on the system's institutions. Lastly, the establishment of robust regulatory supervision and internal governance and risk management systems in each financial institution is key to ensuring safe and sound development of the financial system and preventing problems from reemerging.

Two examples of these levers being applied in practice are the U.S. Savings & Loan crisis of the 1980s and 1990s and the Spanish banking crisis of 2008-2012. More specifically, these cases can provide guidance as to the steps that COSSEC and the cooperative system can take to ensure long-term financial stability and soundness.

U.S. S&L Crisis (1980s)

In the early 1980s, there were 4,000 S&Ls (Savings and Loans associations, also known as ("thrifts")) in the U.S. with total assets of \$600 billion, most of which were mortgage loans. However, most S&Ls relied on short-term deposits for the bulk of their funding, thereby creating

a mismatch between assets and liabilities that left them particularly sensitive to changes in interest rates. Further worsening matters was the fact that S&L rates were capped by the government, which limited the rates that S&Ls could offer on deposits. As other financial institutions offered customers more attractive rates, this caused significant deposit withdrawals from S&Ls. Initially, the government's response was one of forbearance, as the political and monetary cost of "saving" these thrifts was perceived as "too expensive" at the time (according to the Fed, in 1983 the cost to pay off insured depositors of failed S&L was ~ \$25 billion²⁵), and hence it seemed better to patch the system and buy time in hopes that the problem would resolve on its own. However, the mismatch between S&L's floating-rate funding and fixed-rate income only worsened further, resulting in significant declines in S&L net worth. Ultimately, in the late 1980s, 747 S&Ls with assets worth over \$407B were closed, and the total cost to taxpayers was estimated at ~\$130B²⁶.

Despite the government's initial response to the crisis, comprehensive solution to the S&L crisis required changes along the three components outlined at the beginning of this section. Firstly, transparency in accounting was implemented by replacing Regulatory Accounting Principles (RAP) by Generally Accepted Accounting Principles (GAAP), which is the accounting system that is still used today and is overseen by the Financial Accounting Standards Board (FASB). The reason behind this transition in accounting principles was that, under RAP, the true financial condition of S&Ls was not apparent.

Several measures were taken to stabilize the S&L system: minimum capital requirements were implemented, insurance premiums were raised, non-mortgage and mortgage-related holdings were limited, and the divestment of junk bonds was required. In the end, most S&Ls were absorbed by commercial banks, as statutory and regulatory changes were being implemented. Lastly, there were several changes in terms of governance: the main S&L regulator was replaced, thrift insurance was transferred to the FDIC, and the Resolution Trust Corporation was established and funded to address the remaining troubled S&Ls.

Spain's banking crisis (2008-2014)

A similar situation was observed with the banking system in Spain following the 2008 financial crisis. The problem was specifically centered around savings and loans banks that were government-owned but self-regulated and competed against private or commercial banks. As a result of the real estate boom of 2004-2007, retail mortgages and developer loans had come to represent a larger portion of savings banks' balance sheets, and lenient criteria for issuing such loans had resulted in exposure to lower-quality assets (contrary to private banks, which were less aggressive with these loans). With the onset of the global financial crisis and downturn in real estate bubble, Spanish banks were left facing both liquidity and solvency issues, especially with the loss of investor confidence. The impacts of this situation were particularly pronounced: banks witnessed a significant reduction in wholesale funding availability, solvency levels eroded due to

²⁵Federal Reserve. (2020). *Federal Reserve History*. Retrieve from: <https://www.federalreservehistory.org/>

²⁶ Federal Reserve. (2020). *Federal Reserve History*. Retrieve from: <https://www.federalreservehistory.org/>

massive spikes in non-performing loans, and most savings banks went bankrupt. This necessitated large-scale intervention by both the Spanish and European governments (in comparison, most private banks incurred significant losses, but did not require government aid).

The recovery path for the Spanish banking system can also be analyzed in the context of the same three-step framework. In terms of greater transparency in accounting, extraordinary provisioning for real estate-related assets was exercised to reflect real underlying losses in the portfolio (regardless of whether realized) in order to provide a more accurate picture of savings bank balance sheets. This consisted of replacing the previous “incurred loss” model with an “expected loss” model that required the recognition of provisions when objective evidence of impairment existed. Additionally, asset transfer pricing started to be based on the stress-test base scenario.

Several stabilization measures were also taken as banks were consolidated by merging weak institutions into sounder ones through the Fund for Orderly Bank Restructuring (FROB, by its Spanish acronym), a public entity with its own legal regulation; impaired assets were transferred to a government-backed national wind-down unit; transferred assets were focused on real estate related-only assets; and savings banks’ funding structures were bolstered by issuing senior bonds. Finally, steps were taken to fundamentally change governance in these savings banks: as boards and top management teams drastically changed as part of the conditions for government rescue; new oversight policies for banks were instituted by the European Central Bank; and 45% of financial institutions that received government aid eventually became government owned and controlled through FROB²⁷.

The U.S. S&L Crisis and the Spanish banking crisis were both challenging times for the financial industry, but nevertheless offer important insight into how banking and financial systems can be restored. Reforming the cooperative system in Puerto Rico is needed to protect not only the members and depositors of the cooperatives, but also the economy of the Commonwealth at large.

Appendix 2: Cooperatives and Puerto Rico’s macroeconomics

Cooperative’s relation with Puerto Rico’s Macroeconomics

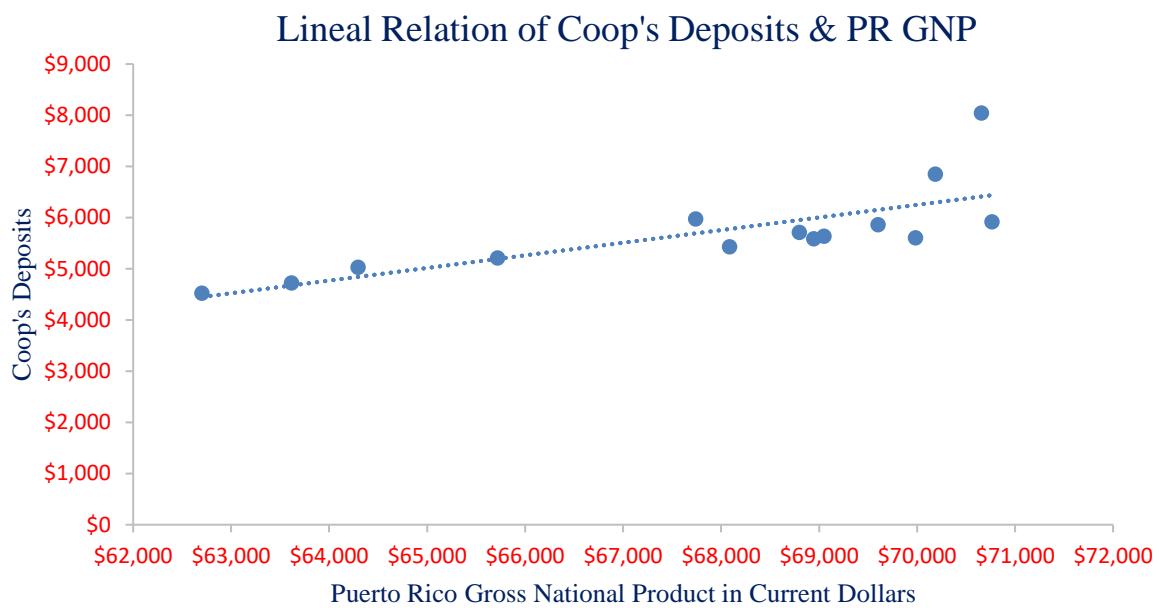
Cooperatives monetary aggregates (shares and deposits) reflect a connection with Puerto Rico’s macroeconomics that COSSEC, as insurer and regulator, should consider in preventing future trends. Cooperative’s shares had a strong positive lineal relation from 2008 to 2021 and significant statistical relation with Puerto Rico’s nominal Gross National Product (GNP). In the case of cooperative’s deposits, the lineal relation with GNP was moderate but still a significant statistical relation.

Cooperative’s shares and deposits follow almost a convergent pattern with the GNP. Nevertheless, in 2020 and 2021 cooperative’s deposits broke away in a divergent pattern or delaying effect with respect to the GNP that could be related to the immediate effect of the three rounds of payments of

²⁷ Banco de España. (2017). *Report on the Financial and Banking Crisis in Spain, 2008-2014*. Retrieve from: <https://www.bde.es/f/webbde/Secciones/Publicaciones/OtrasPublicaciones>

the Federal Government stimulus programs including CARES Act (\$1,200 per adult), Consolidated Appropriations Act (\$600 per adult) and American Rescue Plan (\$1,400 per adult) being translated into cooperative's deposits and a potential delay effect in the GNP. The cooperative's relation with the Puerto Rico's economy is an important factor to be considered by COSSEC, as regulator and insurer of cooperatives, to take advance measures to protect cooperatives from a potential economic cycle that could affect the source of cooperatives' funds. As previously mentioned in chapter 2, the future growth of Puerto Rico's economy is highly indeterminate, because it depends on a set of economic variables that are not determined locally.

EXHIBIT 23: RELATION COOPERATIVES DEPOSITS AND SHARES WITH PUERTO RICO'S GNP



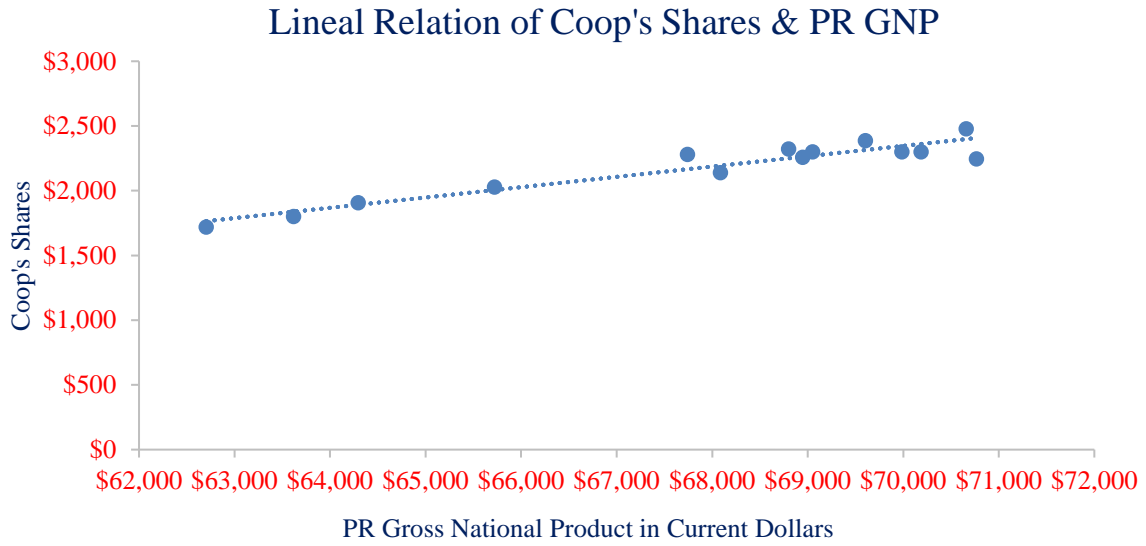


EXHIBIT 24: COOPERATIVE SHARES, DEPOSITS & PUERTO RICO'S GNP

