Financial Oversight & Management Board for Puerto Rico

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

May 18, 2023

2023 COSSEC Fiscal Plan pursuant to PROMESA Section 201(e)

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").

This document does not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review of services in accordance with standards established by the American Institute of Certified Public Accountants or any other organization. Accordingly, the Oversight Board cannot express an opinion or any other form of assurance on the financial statements or any financial or other information or the internal controls of COSSEC and the information contained herein.

This 2023 COSSEC Fiscal Plan is not a Title III plan of adjustment. This 2023 COSSEC Fiscal Plan does not specify classes of claims and treatments, does not discharge debts, and does not extinguish liens.

This 2023 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 2023 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, after certifying this 2023 COSSEC Fiscal Plan, of additional information that the Oversight Board determines warrants a revision of this 2023 COSSEC Fiscal Plan, the Oversight Board will revise it.

For the avoidance of doubt, the Oversight Board does not consider and has not considered anything in the 2023 COSSEC Fiscal Plan as a "recommendation" pursuant to Section 205(a) of PROMESA. Nevertheless, to the extent that anything in the 2023 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 2023 COSSEC Fiscal Plan pursuant to various provisions of Section 201(b) of PROMESA. Under section 5(b) of Act 2-2017, the Puerto Rico Fiscal Agency, and Financial Advisory Authority ("AAFAF", for its Spanish acronym) "shall be the government entity charged with supervising, executing, and administering the Fiscal Plan approved and certified in accordance with PROMESA and shall ensure that all the entities of the Government of Puerto Rico comply with the duly approved Fiscal Plan."

Any statements and assumptions contained in this document, whether forward-looking or historical, are not guarantees of future performance and involve certain risks, uncertainties, estimates, and other assumptions made in this document. The economic and financial condition of COSSEC and the cooperative systems is affected by various legal, financial, social, economic, environmental, governmental, and political factors. These factors can be very complex, may vary from one fiscal year to the next and are frequently the result of actions taken or not taken, not only by the Government and the Oversight Board, but also by third-party entities such as the government of the United States.

Because of the uncertainty and unpredictability of these factors, their impact cannot be included in the assumptions contained in this document. Future events and actual results may differ materially from any estimates, projections, or statements contained herein. Nothing in this document should be considered as an express or implied commitment to do or take, or to refrain from taking, any action by the Oversight Board, the Government, or any instrumentality in the Government, or an admission of any fact or future event. Nothing in this document shall be considered a solicitation, recommendation, or advice to any person to participate in, pursue or support a course of action or transaction, to purchase or sell any security, or to make any investment decision.

By receiving this document, the recipient is deemed to have acknowledged the terms of these limitations. This document may contain capitalized terms that are not defined herein or may contain terms that are discussed in other documents or that are commonly understood. You should make no assumptions about the meaning of capitalized terms that are not defined, and you should refer questions to the Oversight Board at comments@promesa.gov should clarification be required.

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, and Liquidity
CAGR	Compound Annual Growth Rate
CAMEL	Capital adequacy, Asset quality, Management, Earnings, and Liquidity
CARES Act	The Coronavirus Aid, Relief, and Economic Security Act
CCFP	Certified COSSEC Fiscal Plan
CDC	Cooperative Development Commission
CD	Certificates of Deposit
CECL	Current Expected Credit Loss
CIF	COSSEC Insurance Fund
CMOS	Collateral Mortgage Obligation
COSSEC	Public Corporation for Supervision and Insurance of Cooperatives of Puerto Rico by its Spanish acronym
COSVI	Life Insurance Cooperative of Puerto Rico
COVID-19	Coronavirus pandemic
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation

FICO® Score	Index for measuring consumer credit risk introduced by the Fair Isaac Corporation
FOMB	The Financial Oversight and Management Board for Puerto Rico
FROB	Fund for Orderly Bank Restructuring, by its Spanish acronym
G-25	G-25 Steering Committee Members and Financial Cooperatives of Puerto Rico
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
PROMESA	Puerto Rico Oversight, Management, and Economic Stability Act
PCA	Prompt Corrective Action
PROSAD-COOP	Savings and Credit Cooperative Shares and Deposits Insurance Corporation
RAP	Regulatory Accounting Principles
ROA	Return on Assets
S&L	Savings and Loans associations, also known as “thrifts”
TDR	Troubled Debt Restructured
TMO	Transformation Management Office

Table of Contents

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. Access to banking and financial services is an essential contributor to economic growth and development. The cooperative system plays a critical role in fulfilling this need, particularly outside the metropolitan San Juan area.

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, have been publicly reported, and have been cited in prior CCFPs. 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. 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 1.1 million residents of Puerto Rico who depend on cooperatives for access to financial services.

The 2023 COSSEC Fiscal Plan ("2023 CCFP") 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 GAAP[1] 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.

A work in progress

While this 2023 CCFP continues to outline the key measures needed to improve COSSEC's ability to regulate the system, it will be effective only if COSSEC steps up the scale and pace of its own transformation and if the Government enacts implementing legislation where necessary. COSSEC has continued to implement certain measures that have been required under CCFPs, including corrective actions on insolvent and undercapitalized cooperatives, supporting the approval of Act 44-2022, allowing the voluntary merging of distressed cooperatives with more stable ones with COSSEC assistance, decreasing the systemic risk of the cross-deposits among cooperatives' deposits at BCPR, and recommendation from COSSEC actuary to implement a local version of the NCUA equity ratio known as "designated ratio" to support COSSEC resources

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.

based on the ratio of COSSEC net worth relative to total insured shares and deposits. Finally, COSSEC has claimed that it is "adequately funded" based on NCUA standards.

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.

The Government and COSSEC recommended a 5-year extension deferring the completion date of the financial cooperatives' transition from RAP to GAAP from June 2025 as provided in the 2022 CCFP, to June 2030 because the Government has not yet enacted legislation to eliminate special accounting treatment that permits cooperatives to amortize over a 15-year period any losses resulting from the default of Puerto Rico government bonds. Furthermore, the completion of the transfer of the regulatory power of non-financial cooperatives to the Cooperative Development Commission ("CDC") is also contingent on the enactment of legislation. Finally, based on recent meetings with and reports from the Government and COSSEC, COSSEC will need additional time to complete the intervention of insolvent or undercapitalized cooperatives and therefore requires an extended period for the resolution of cooperatives with major financial concerns through a 3-phase intervention process.

Further delays to the CCFPs' milestones will only exacerbate the risks to the cooperative system. Accordingly, the 2023 CCFP continues to include details on the actions, timelines, and milestones required to intervene in and implement final resolution for any insolvent cooperatives. The 2023 CCFP continues including 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.

Context for COSSEC and current challenges for the cooperative system

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, 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. Also, during the 2015 the Legislature and the Government approved a law known as Act 220-2015 with local accounting rules that differed from GAAP for financial cooperatives' Puerto Rico municipal bonds. 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 1.1 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 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,

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

and gender inequality, among others, are reduced when countries strategically advance financial inclusion though the collaboration of actors in the public, private and social spheres[3].

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). 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

Like 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 102 locally chartered, regulated, and insured credit unions, holding ~$10.6 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

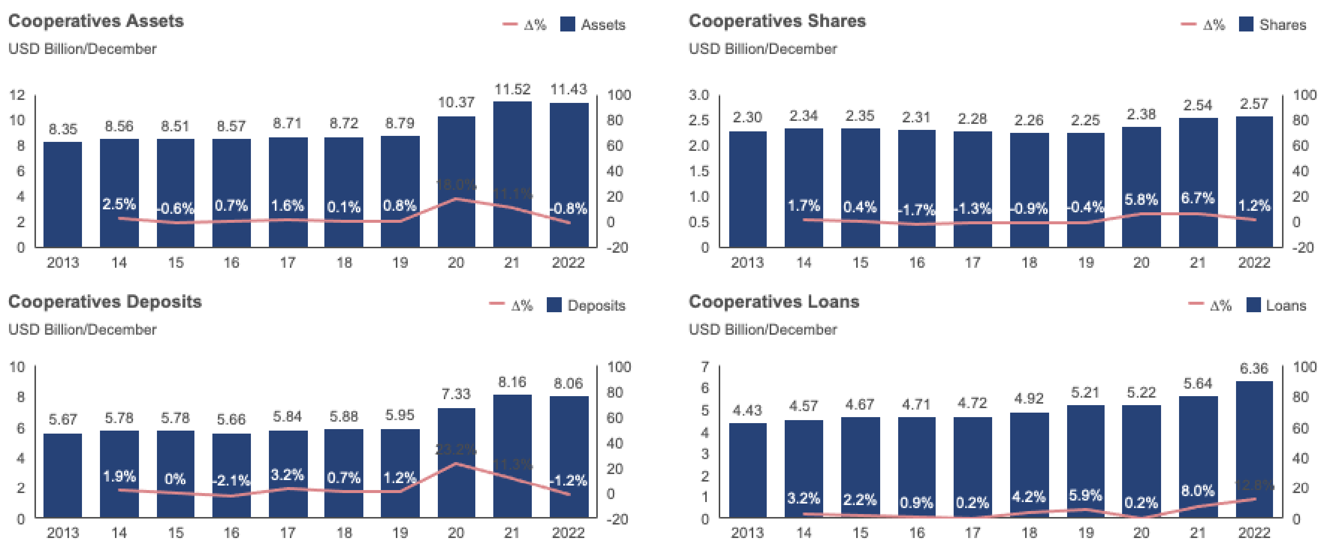
The cooperative system continues to attract more than one million of Puerto Rico's low-to-middle-income population who depend on cooperatives for access to financial services, and it continues to stimulate local initiative and local economic strength. This suggests the relevance it has in driving economic 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 33.5% between 2014 and 2022 (CAGR of 3.26%) because of an increase in shares of 9.8% (CAGR of 1.05%) and deposits of 39.4% (CAGR of 3.76%) respectively. During 2022, deposits decreased by 1.2% from previous year associated with the delaying effect of the phasing-out of the 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 2 for more details). The decrease in deposits reaffirms the 2022 CCFP recommendation of taking into consideration the cooperatives' risk tolerance, reserve requirements and asset liability management.

---

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

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

EXHIBIT 1: ASSETS, SHARES, DEPOSITS & LOANS ($ BILLION)



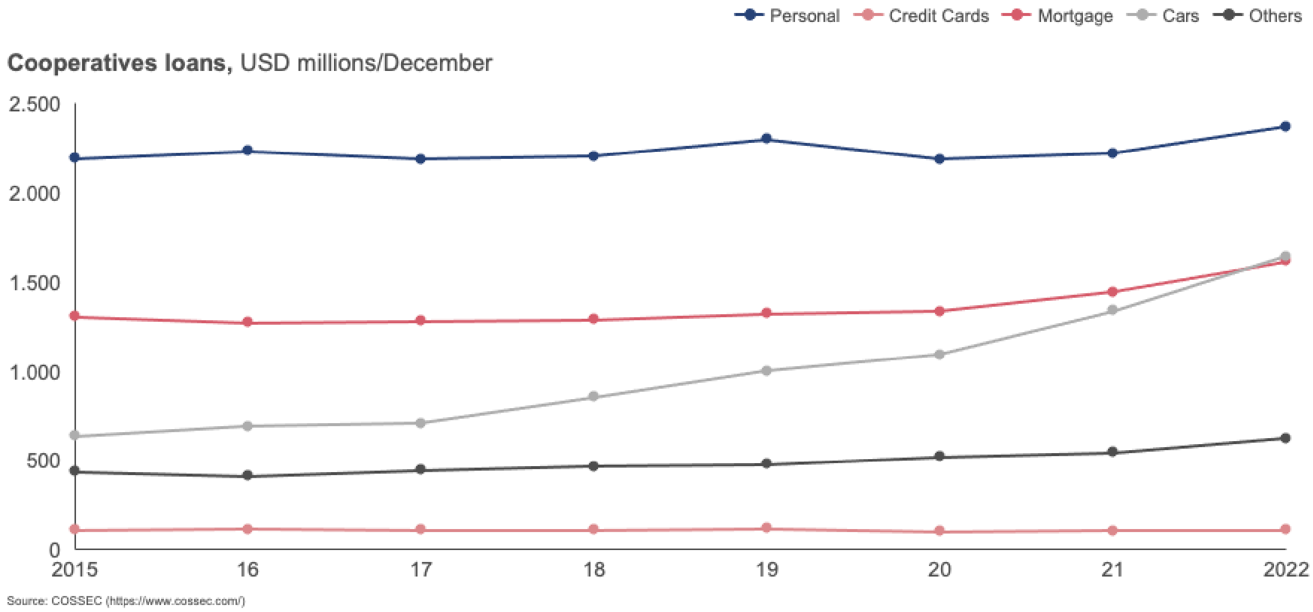
Source: COSSEC (https://www.cossec.com/)

Loan portfolio composition

In line with the socially driven mission of cooperatives, members' deposits and shares are often pledged as the guarantee for loans. When it comes to the cooperative loan portfolios, $2,367 million are personal loans, $1,642 million cars loans, $1,614 million mortgage loans, $623 million other loans, and $110 million credit cards (as of December 2022). Of these, 44% have physical collateral, which reduces the chance of loss in a default scenario. The 2021 CCFP (p. 12) and 2022 CCFP (p. 6) emphasized that cooperatives' car loan growth had exceeded other loan types. Updated data reflect that car loans more than doubled from $560.91 million in 2014 to $1,641.77 million in 2022 (Exhibit 2 or 192.7% (CAGR 14.37%).

During the same period, cooperatives' assets increased from $8,557.57 million to $11,425.11 million or 33.5% (CAGR 3.68%), which means that car loans increased approximately 6 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 vital role that they play in communities across Puerto Rico by meeting these needs. As the regulator and insurer of the cooperative system, 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. The Oversight Board understands that COSSEC should closely monitor the car loans exposure and ensure that adequate reserves convergent with the risk exposure are established.

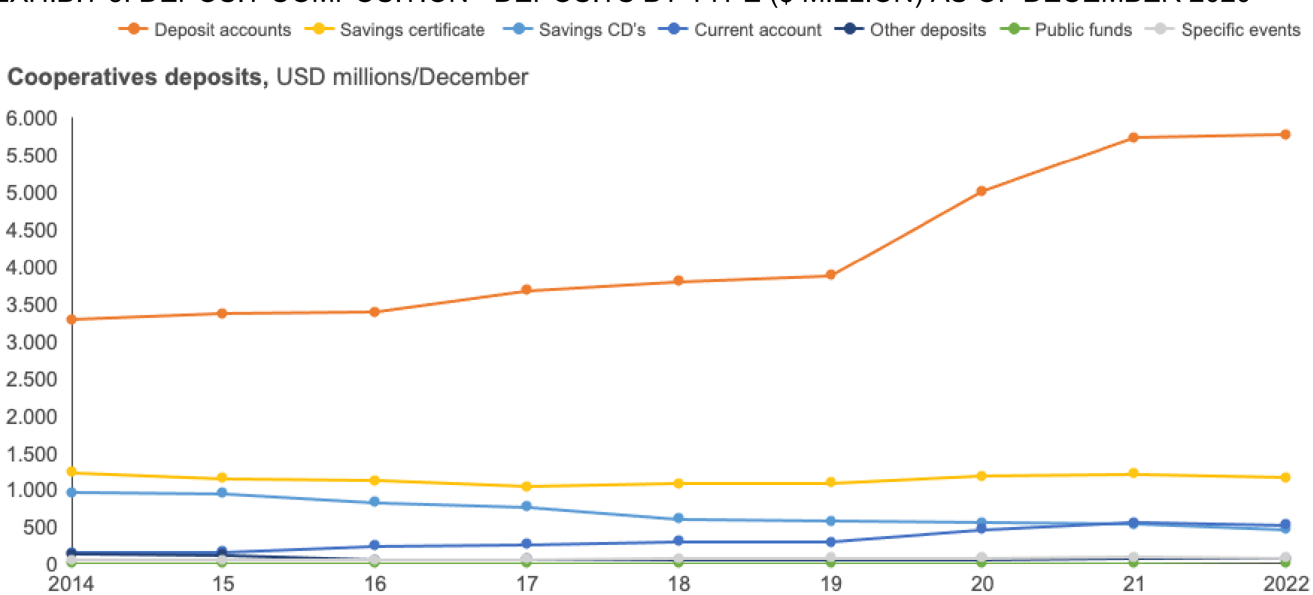
EXHIBIT 2: LOAN PORTFOLIO COMPOSITION - LOANS BY TYPE ($ MILLION)



Deposit composition

The cooperative system holds $8,055 million in deposits. These deposits are mainly made up of $5,768 million of deposits accounts, $1,156 million savings certificates, $519 million current accounts, $463 million certificates of deposit ("CDs"), and $81 million and $69 million specific events and other deposits, respectively. Certificates of Deposit ("CDs") consist of a lump-sum that is "locked-up" for a longer period in exchange for an interest premium, and early withdrawal usually results in a penalty for the depositor. Although deposit accounts increased by $46 million during 2022, certificate of deposits and current accounts decreased by $65 million and $37 million, respectively, which may be related to the phasing-out process of 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.

EXHIBIT 3: DEPOSIT COMPOSITION - DEPOSITS BY TYPE ($ MILLION) AS OF DECEMBER 2020



Assets, Liabilities & Capital

As of December 2022, the cooperative system had the following balance sheet based on RAP accounting, which reveals that although financial cooperatives' assets slightly declined during 2022, the ratio of capital (including shares) relative to assets increased from 27.7% to 27.9%. As cooperatives transition from RAP to GAAP, shares will be included as part of the cooperatives' liabilities and will no longer be reported as part of their capital.

EXHIBIT 4: COOPERATIVES' BALANCE SHEET AS OF DECEMBER 2021 AND 2022 BASED ON RAP

December 2021

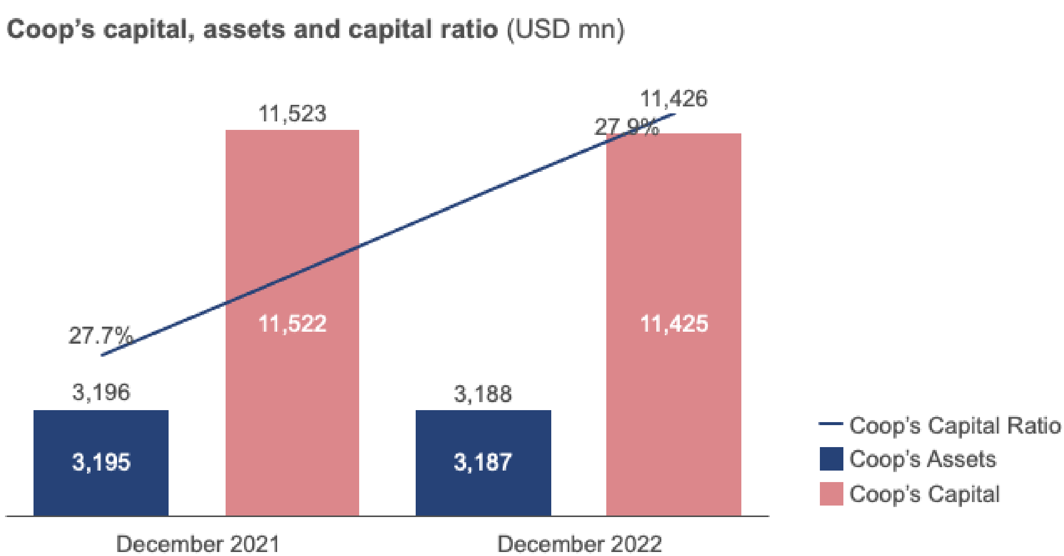
Assets ($ million)		Total deposits	8.160
Cash	1.027	Account payable	167
Total loans	5.642	**Total liabilities**	**8.327**
Loan loss provision	-146	Shares	2.536
Savings accounts & certificates	2.010	Capital obligations	11
Total investment in securities	1.950	Indivisible capital reserve	358
Total investment in cooperatives	321	Investment valuation reserve	-11
Land & property	320	Other reserves	294
Other assets	398	Surplus	7
Total assets	**11.522**	**Total equity**	**3.195**
		Total liabilities + equity	**11.522**

December 2022

Assets ($ million)		Total deposits	8.055
Cash	527	Account payable	183
Total loans	6.356	**Total liabilities**	**8.238**
Loan loss provision	-162	Shares	2.568
Savings accounts & certificates	1.215	Capital obligations	7
Total investment in securities	2.525	Indivisible capital reserve	370
Total investment in cooperatives	328	Investment valuation reserve	-129
Land & property	311	Other reserves	332
Other assets	325	Surplus	39
Total assets	**11.425**	**Total equity**	**3.187**
		Total liabilities + equity	**11.425**

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

EXHIBIT 5: CAPITAL, ASSETS & CAPITAL RATIO COMPARISON AS OF DECEMBER 2021 AND 2022 BASED ON RAP



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 authority 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:

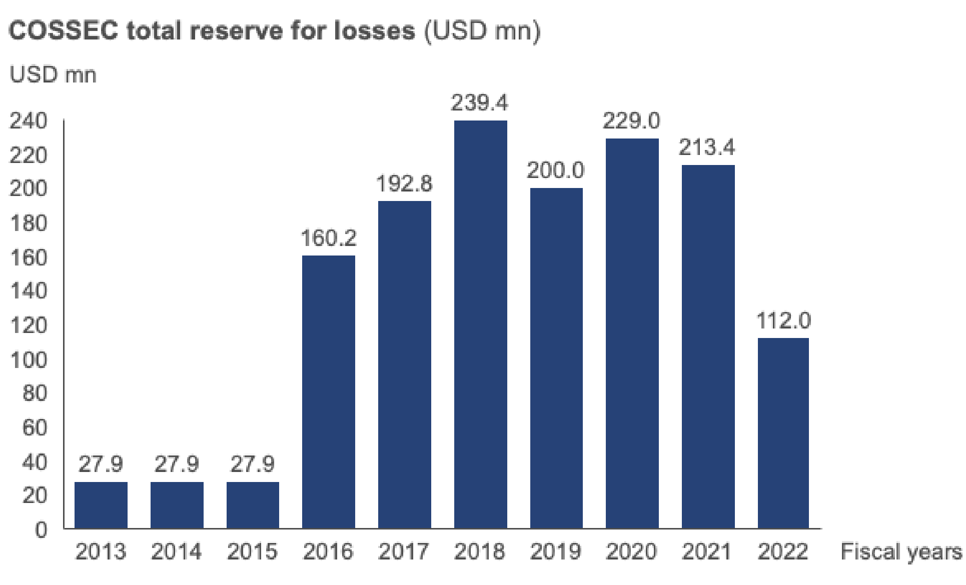
- Comprehensive oversight and supervision of cooperatives to ensure compliance with regulations regarding their operations, businesses, products, and/or services,
- Providing shares and deposit insurance for savings and loans cooperatives,
- Ensuring economic solvency of cooperatives, particularly credit 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 involving 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 total reserve for losses incorporates 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 actuary total reserve for losses also includes a reserve for unknown losses based on the actuarial estimated financial risk of the remaining cooperatives.

EXHIBIT 6: COSSEC RESERVE FOR EXPECTED LOSSES (FISCAL YEAR)



Source: CPA Audited Financial Statement

During fiscal years 2013 through 2015, the COSSEC total reserve for 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. In the fiscal year 2022, COSSEC total reserve for losses decrease around 48% from previous year to $112 million, which reflects the reduction of risk and progress against prior CCFP requirements related to supervisory interventions to address insolvent cooperatives.

This historical trend of the COSSEC total reserve for 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 prior CCFPs, there is still work to be done to bring COSSEC and the cooperative system to the levels of the total reserve for losses prior to the year in which COSSEC was designated as a covered entity under PROMESA. The Oversight Board continues to urge the Government and COSSEC to take actions to ensure the stability of the cooperative system by implementing the reforms in prior CCFPs and in the 2023 CCFP. 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.

COSSEC Insurance Fund

In terms of investment portfolio composition, COSSEC has $303 million in total investments (market value), including US Agencies (29%), US municipal bonds (29%), US corporate bonds (28%), US Treasury bonds (9%) and mortgage-backed securities (5%). Portfolio risk and return analytics show an average credit rating of AA, average coupon rate of 3.35%, and a yield to maturity of 2.99%. The reduction in the COSSEC Insurance Fund suggests the combined effect of the interest rate risk associated with investing in bonds plus implementing the corrective actions linked with the milestone of supervisory interventions (sales of assets and liabilities, liquidation, and involuntary or voluntary merging) in accordance with the contract review policy of Section 204(b)(2) of PROMESA.

EXHIBIT 7: COSSEC INSURANCE FUND INVESTMENT PORTFOLIO COMPOSITION

Investment detail (000's)	31-12-21, $	%
PR debt	0	0
Mortgage-backed Securities	49.044	15
US corporate bonds	102.775	31
US treasury	5.239	2
US agencies	59.391	18
US munis	120.352	36
Other	0	0
	336.801	**100**

Investment detail (000's)	31-12-22, $	%
PR debt	0	0
Mortgage-backed securities	14.544	5
US corporate bonds	84.988	28
US Treasury	27.073	9
US Agencies	89.128	29
US Munis	87.244	29
Other	0	0
	302.977	**100**

Volatility in financial markets due to the increase in inflation[5], geopolitical risk, and the increase of interest rates by the Federal Reserve[6] 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 prepare every year a risk management report for the COSSEC Insurance Fund,** with a stress 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 COSSEC Insurance Fund as a result of addressing insolvent cooperatives at a time where increases in interest rates may be rising. Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.

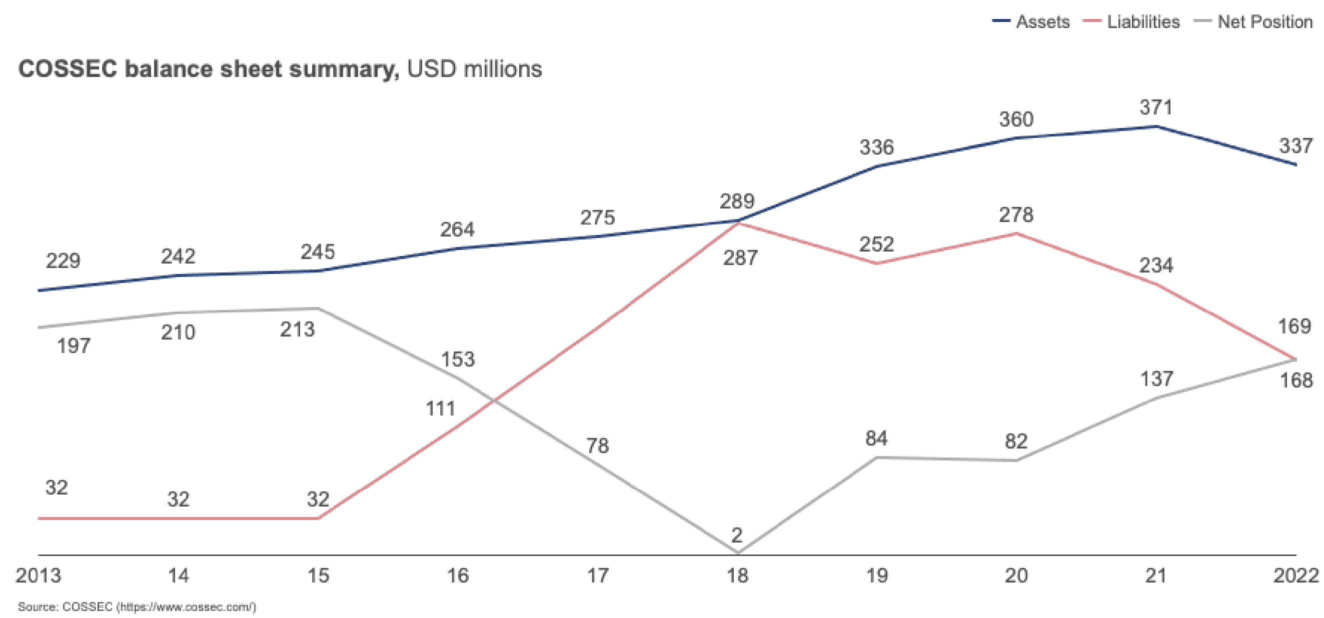
[5] Guilford, G. (2022). U.S. Inflation Hit 7% in December, Fastest Pace Since 1982. Wall Street Journal. https://www.wsj.com/articles/us-inflation-consumer-price-index-december-2021.
[6] Federal Reserve. (2022). *Federal Reserve Press Release*. https://www.federalreserve.gov

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 to $371 million in 2021 but decreased to $337 million during 2022 due to a reduction in the COSSEC Insurance Fund.

Moreover, COSSEC's net position and liabilities finished at $137 million and $234 million respectively during 2021. Nevertheless, during 2022, the net position of $169 million exceeded liabilities of $168 million due to a reduction of COSSEC's reserve for expected losses, which account for around 83% of the liabilities. The reduction in COSSEC's assets and liabilities reflects the combined effect of the interest rate risk associated with investing in bonds and the implementation of the corrective actions associated with the milestone of supervisory interventions (sales of assets and liabilities, liquidation, involuntary or voluntary merging) in accordance with the contract review policy of Section 204(b)(2) of PROMESA).

EXHIBIT 8: COSSEC BALANCE SHEET



Key stakeholders in the cooperative system

The Oversight Board has consulted a broad range of stakeholders 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") and G-25.

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). Although Article 20 of Act 114-2001 allows bidding transactions with non-cooperatives when cooperatives are not interested in bidding, the Government must submit legislation to resolve the discrepancy between Act 114-2001 and Act 255-2002 on this matter.

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 considering the long-term reduction in population in Puerto Rico. This surge in cooperative branches has happened while local commercial banks have reduced branches by 43% between 2006 and 2016[7]. While an increase in cooperative branches may have benefits in certain communities, COSSEC should ensure that the branch network is sustainable given the resources of the cooperative system. From that standpoint, COSSEC should review a forecast of the effect of Puerto Rico's demographic and economic trends on the cooperatives' ROA before and after the potential approval of a branch or service office as part of its internal analyses when evaluating a cooperative's request to establish branches and services offices.

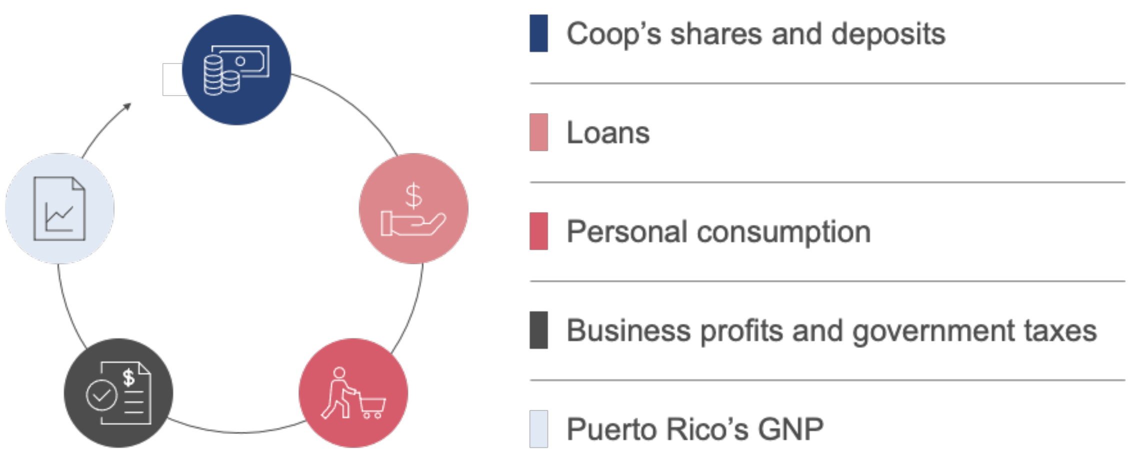
Chapter 2. Cooperatives' contribution to Puerto Rico's economy

Cooperatives' money creation process in Puerto Rico's economy

In general terms, as financial economists would say, depository financial institutions (such as financial cooperatives) "can literally create money by making loans or by purchasing bonds."[8] That said, financial cooperatives contribute more closely to the day-to-day of local business activity and Puerto Rico's economy through the process of channeling funds from shares and deposits into loans to finance the acquisition of goods and services by the people and businesses within Puerto Rico.

This increase in consumption of good and services creates a multiplier effect from the initial spending created out of cooperative loans and the subsequent spending into businesses profits (for example: car dealers) and government taxes (for example: motor vehicles excise tax) that ripple through all Puerto Rico's economy in a circular flow (see Exhibit9).

EXHIBIT 9: COOPERATIVES' CONTRIBUTION TO THE LOCAL ECONOMY



Cooperatives' 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. Cooperatives' shares had a strong positive lineal relation and significant statistical relation with Puerto Rico's nominal Gross Nation Product (GNP) from 2008 to 2021. In the case of cooperative deposits, the lineal

[7] El Vocero (2017). Drástica reducción de sucursales bancarias en la Isla. https://www.elvocero.com/economia/dr-stica-reducci-n-de-sucursales-bancarias-en-la-isla
[8] Colander, D. (2016). *Economics*. (10th ed.) New York, NY: McGraw-Hill Education.

relation with GNP was also strong, which constitutes a change in trend from 2022 CCFP moderate statistical relation attributed to using preliminary data instead of forecasting of the GNP.

In the 2023 CCFP, cooperatives' shares and deposits lineal trend with Puerto Rico's GNP follows a convergent pattern with the GNP without the data divergent pattern of the 2022 CCFP, which could be the delaying effect of the phasing-out of 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).

The cooperatives' 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. In that regard, the CWCFP (Volume 2, Page 6) concluded that *the unprecedented one-time influx of federal funds has strengthened the economy during the pandemic, but those funds are waning and may mask underlying weaknesses in the Island's economy*. That warning reinforces the notion that Puerto Rico's economy has been highly indeterminate because of the set of economic variables that are not determined locally.

EXHIBIT 10: RELATION OF COOPERATIVES' DEPOSITS AND SHARES WITH PUERTO RICO'S GNP

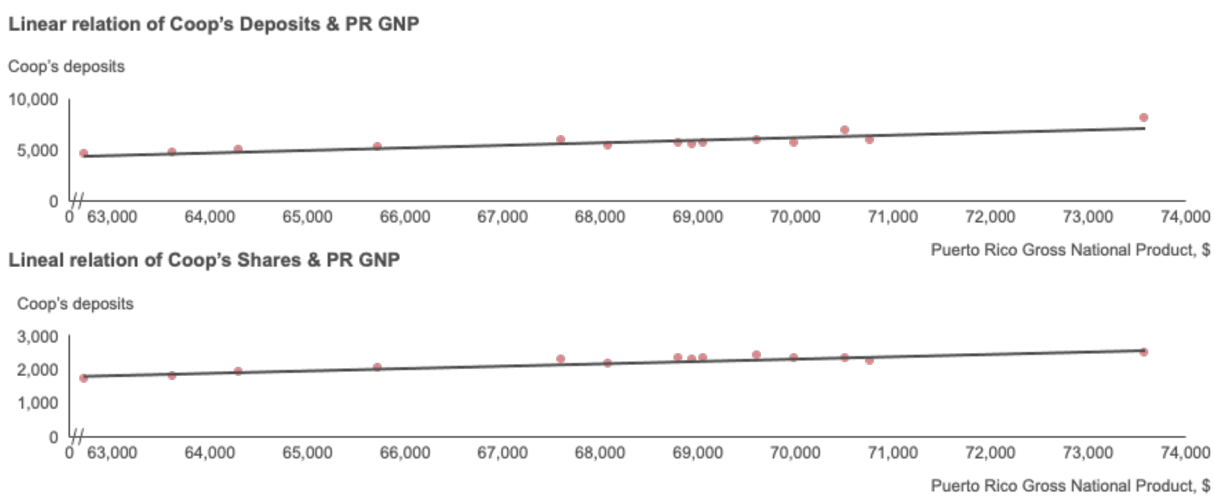
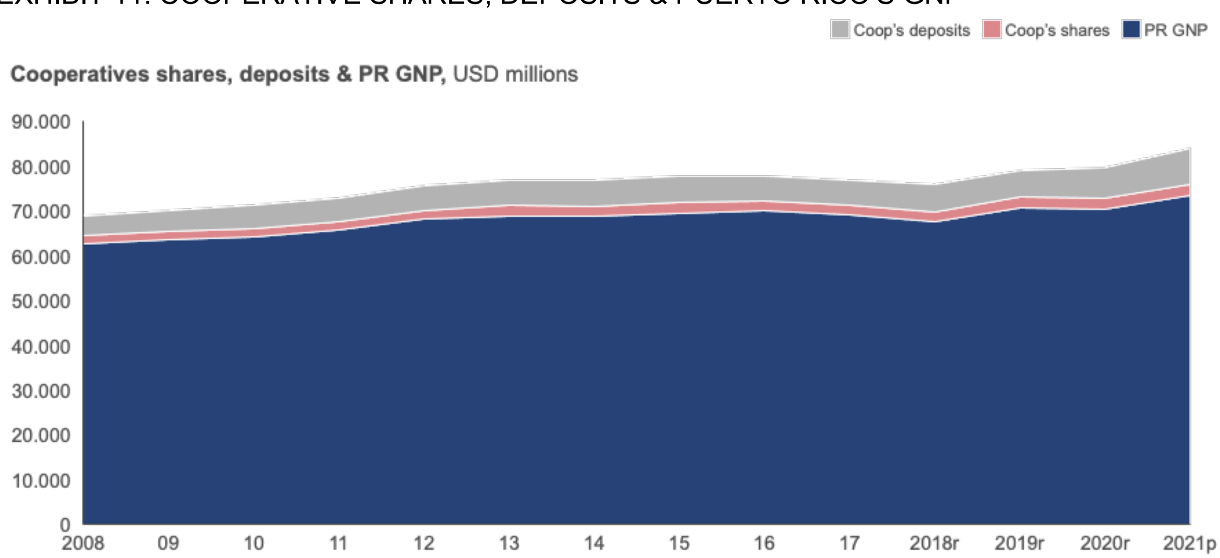


EXHIBIT 11: COOPERATIVE SHARES, DEPOSITS & PUERTO RICO'S GNP



Source: COSSEC (https://www.cossec.com) & Puerto Rico Planning Board (http://jp.pr.gov).

Chapter 3. Financial challenges facing the cooperative system

In recent years, despite the significance of the cooperative system to the economy of Puerto Rico, the cooperative system 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.

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 No. 7051 allowed "adequate condition cooperatives 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 No. 7051 leverages the CAMEL[9] 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)[10]. CAMEL is used to score institutions between one (best) and five (worst), with any score higher than a three being considered less-than-satisfactory[11]. Pursuant to Regulation No. 7051, cooperatives ranked between one and three were determined to be in adequate condition 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[12] across cooperatives ($464 million) and BCPR ($461 million). COSSEC has increasingly been challenged to understand and manage the risks from the interconnected 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 to evaluate the risk that cooperatives' investments might lose value. In the case of cross-deposits, COSSEC's analysis of stress scenarios at the individual cooperative level might not fully capture the system-wide risks involved when multiple cooperatives hold deposits with each other.

During the period of the 2021 CCFP, cooperatives' cross-deposits were initially set at $544 million, followed by an increase to $555 million during the 2022 CCFP and by a reduction to $464 million in the 2023 CCFP. The latest decrease of 16% in cross-deposit is a positive trend toward phasing-out the systemic risk that represents the cross-deposits within the cooperative system. The case of cooperatives' exposure to other

---

[9] Corporación Pública para Supervisión y Seguro de Cooperativas de Puerto Rico (COSSEC). (2021). *Reglamento para Establecer el Sistema de Evaluación Financiera CAMEL.* https://www.cossec.com/cossec_new/publications.

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

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

[12] Although the CCFP does not enter in the definitional aspect of the cross-deposits vis a vis deposits per se, there could be instances in which a deposit into a cooperative does not cross specifically with another deposit from the same cooperative.

cooperatives could represent a higher cost to the COSSEC Insurance Fund when implementing a final resolution to insolvent cooperatives, especially when cross-deposits exceed the insurance limit.

Given the above, it is important to further differentiate between cross-deposits 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. As such, **COSSEC must prepare every year a report setting forth the amount and number of cross-deposits above and below $250,000 among solvent and insolvent cooperatives.** Refer to Exhibit 23 for details of the 2023 CCFP COSSEC reporting requirements.

Cooperatives' exposure to other cooperatives and to BCPR could be considered 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 crucial element considered by the Basel Committee is the "liquidity support" necessary to face financial interconnection during potential crisis.[13] During the period of the 2021 CCFP, cooperatives' deposits at BCPR were $586 million, following by an increase to $774 million during the 2022 CCFP and by a reduction to $461 million in the 2023 CCFP.

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 ratios[14] comparable with those of 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 the COSSEC Insurance Fund to the BCPR, **COSSEC must prepare a risk assessment report of the BCPR including the risk exposure of cooperatives' $461 million deposits at BCPR.** Refer to Exhibit 23 for details of the 2023 CCFP COSSEC reporting requirements.

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 Examination Council (FFIEC).[15] 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 2023 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,[16] 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 Technology (NIST)[17] is a

---

[13] Bank for International Settlements. (2021). *Identification and management of step-in risk.* https://www.bis.org/bcbs/publ/d423.pdf

[14] Federal Deposit Insurance Corporation. (2022). *Risk Management Manual of Examination Policies.* https://www.fdic.gov/regulations/safety/manual/section2-1.pdf.

[15] Federal Financial Institutions Examination Council. (2017). *Cybersecurity Assessment Tool.* https://www.ffiec.gov/pdf/cybersecurity/FFIEC_CAT_May_2017.pdf

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

[17] National Institute of Standards and Technology. (2018). *Framework for Improving Critical Infrastructure Cybersecurity Version 1.1.* https://www.nist.gov/publications/framework-improving-critical-infrastructure-cybersecurity- version-11

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. Also, the U.S. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA) and NCUA[18] alerted that actual geopolitical events 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. More recently, according to the Puerto Rico Innovation & Technology Service (PRITS) 2022 Annual Report (p. 10),[19] PRITS has identified and successfully blocked over 600 cyber-attacks within the Government of Puerto Rico including ransomware[20] incidents with the Puerto Rico Highways and Transportation Authority (PRHTA) Auto-Expreso system, the Office of Legislative Services and the Municipality of Vega Alta. Based on the previous information, the outcome of a cyber-attack should be consider as a factor that could lead to increase COSSEC's long-term insurance obligations.

To that end, COSSEC should develop a security control framework with its corresponding objectives and ensure that cooperatives comply with these objectives. In addition, COSSEC should provide recommended corrective actions if cooperatives are not meeting the objectives and recommend cost efficient actions to help cooperatives to improve their cyber resilience.

Chapter 4. COSSEC efforts to date

Analysis of capital adequacy

Many cooperatives have accumulated losses that threaten their long-term viability and solvency. Those include several 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 cooperatives' financial statements.

COSSEC has provided a stress test scenario[21] that adjusts cooperatives' current financial reporting in the following ways:

- **Cooperatives' shares adjustment:** treat cooperatives' shares as liabilities, not as capital.
- **Market value adjustment:** value assets including Puerto Rico Government Bonds at market value.
- **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.[22]
- **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 limit in which it is required, will depend on a variety of factors. However, it

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

[19] Puerto Rico Innovation & Technology Service. (2022). *Informe Annual 2022* https://www.prits.pr.gov/comunicados/directora-de-prits-destaca-logros-y-proyectos-del-2022

[20] According to the Federal Bureau of Investigation (FBI) a ransomware is a "type of malicious software, or malware, that prevents you from accessing your computer files, systems, or networks and demands you pay a ransom for their return". https://www.fbi.gov/how-we-can-help-you/safety-resources/scams-and-safety/common-scams-and-crimes/ransomware.

[21] From the perspective of the Federal Reserve and in the context of the COSSEC Fiscal Plan, a stress test is an "evaluation of the resilience" of cooperatives by estimating capital adequacy under hypothetical scenarios into the future.

[22] 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.

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

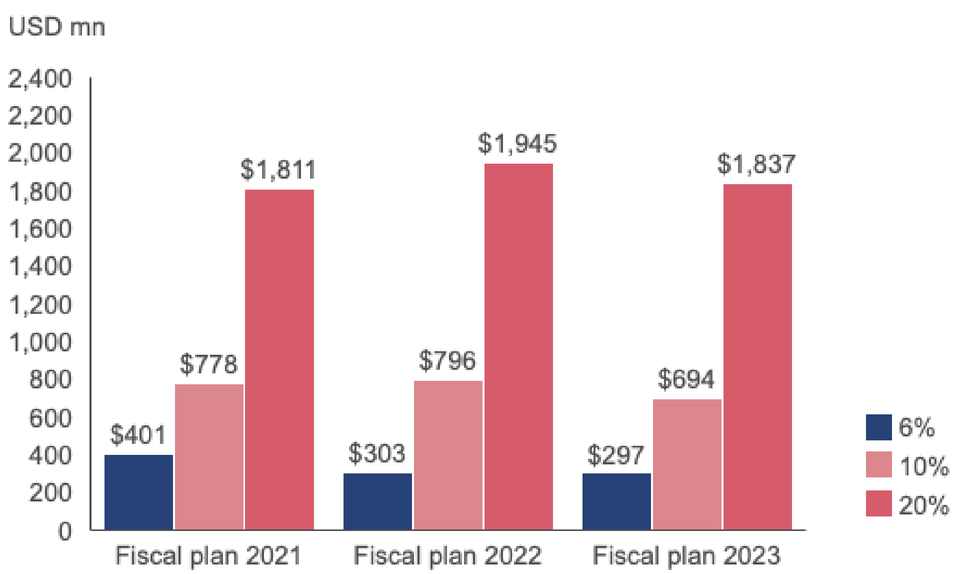
Within COSSEC's actuarial report, four cooperative categories have been defined based on the extent of capital requirements that cooperatives are facing. Specifically:

- *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 2023 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 4 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 cooperatives, the NCUA analysis includes three parameters of target capitalizations of 6%, 10% and 20%.

According to the Government and COSSEC, the NCUA 6% capitalization requirement decreased from $303 in the 2022 CCFP to $297 in the 2023 CCFP, and the 10% and 20% capitalization requirements also decreased from $796 to $694 and from $1,945 to $1,837, respectively. Although COSSEC has claimed that it is "adequately funded" based on NCUA standards, this is an ongoing process, and, as COSSEC continues implementing the milestones of supervisory interventions, COSSEC must continue to update the milestone of financing under the scenarios explored in this chapter toward a better-capitalized cooperative system able to withstand a financial shock.

EXHIBIT 12: 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.

Reform measures to the cooperative system

2023 COSSEC Fiscal Plan pursuant to PROMESA Section 201(e)

Part II: Reform measures for the cooperative system

The 2023 CCFP 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 have been built around three main axes of reform for financial systems: implementing changes in governance; increasing transparency in accounting; and improving supervisory interventions. In addition, COSSEC should prepare for all contingencies and plan to protect the COSSEC Insurance Fund to provide the resources needed to address troubled and at-risk cooperatives. COSSEC should also ensure that it has the structure and resources to be effective and able to adapt to the continually changing financial services marketplace.

The required implementation milestones to pave the way toward a healthier, more sustainable cooperatives system based on global best practices are summarized in Exhibit 13 below:

EXHIBIT 13: SUMMARY OF MILESTONES

Theme	Area of reform	Milestone	Deadline
Milestones required to improve governance, oversight and supervision	Governance	Government and COSSEC submits legislation for board of director's reform.	Ordinary Session
		Government and COSSEC implement Board of Directors changes.	After legislation becomes a law
	Transparency in accounting	Government and COSSEC submits legislation for RAP to GAAP Accounting.	Ordinary Session
		Widespread adoption of GAAP accounting	June 30, 2028
	Supervisory Interventions (identification of Coop's at risk, risk examination, and corrective actions)	Government and COSSEC submits legislation to repeal article 11.02 (d) of Act 220-2015 to allow for interventions of insolvent cooperatives.	Ordinary Session
		Complete corrective actions with insolvent and undercapitalized cooperatives.	June 30, 2025
		Government and COSSEC submit legislation to amend Section 7.02 of Act 255-2002 to allow non-cooperatives to participate in P&A bidding process.	Ordinary Session
	Non-financial cooperatives	Government and COSSEC submit legislation to transfer non-financial cooperatives to the CDC.	Ordinary Session
		Government and COSSEC transfer non-financial cooperatives to CDC.	After legislation becomes a law
Milestones required to advance digital and technology capabilities	Digital and Technology Capabilities	Government and COSSEC must submit a status report of the level of cybersecurity among financial cooperatives with the following: • Number of financial cooperatives that routinely perform: – Vulnerability testing – Penetration testing • Recommendations of "cost efficient course of actions" for those cooperatives that lack adequate testing mechanisms to prevent cyber-attacks.	November 24, 2023
Milestones required to improve contingency planning	Financing	Updated plan showing how it would ensure adequate funding for COSSEC for COSSEC under the stress test scenarios explored in Chapter 4 by active cooperatives with their respective accounting adjustments.	August 4, 2023
Milestones required to build COSSEC resources	COSSEC Resources	Government and COSSEC must submit legislation to amend Act 114-2001 to implement the of a minimum "designated ratio" of audited net worth to insured shares and deposits of 1.35 per cent of total insured shares and deposits.	Ordinary Session
Milestones required to optimize COSSEC organizational structure	Organizational Structure	Government and COSSEC must submit 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

Chapter 5. Measures required to improve governance, oversight, and supervision

COSSEC, individual cooperatives and all stakeholders must 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 2023 CCFP continues to require improving **transparency in accounting** and implementing **improved supervisory interventions** to protect the integrity of the system. Along these lines, the 2023 CCFP will extend the date for **addressing and resolving cooperatives with major financial concerns to the end of Fiscal Year 2025** in line with COSSEC's process to complete the revision of the capitalization plans for insolvent and undercapitalized cooperatives. The milestone of the supervisory intervention encompasses a 3-phase intervention process of identifying cooperatives at risk, examining the risk, and taking corrective actions. 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 must be reformed to ensure that it is an independent body able to take necessary actions to protect the COSSEC 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.

Based on COSSEC's dual role as insurer and regulator, COSSEC's governance structure must enable COSSEC to take prompt corrective action (PCA) to resolve the problem of insolvent and undercapitalized cooperatives that have accumulated millions in losses, which have the effect of increasing the long-term cost to the COSSEC Insurance Fund and generating risks and higher insurance premium payments for the solvent cooperatives.

Until legislative approval to reform COSSEC governance has been obtained, COSSEC should incorporate the PCA protocol in line with NCUA and FDIC. In that regard, the NCUA Act (12 U.S. Code § 1790d - Prompt corrective action) provides that the purpose of the PCA approach is to "resolve the problems of insured credit unions at the least possible long-term loss to the Fund."

Article 6.02(a)(1) of Act 255-2002 requires that cooperatives have at least 8% of indivisible capital subject to its risk assets. Also, Article 6.02(a)(3) provides that, when cooperatives do not comply with Article 6.02(a)(1), COSSEC will require a capitalization plan. Finally, Article 6.02(a)(3)(B) says that, if the capitalization plan is not approved or, after having been approved, reflects a "substantial incompliance," COSSEC could consider other regulatory actions.

Moreover, the COSSEC TMO report indicates that COSSEC would evaluate the capitalization plans previously requested to insolvent and undercapitalized cooperatives between January and June 2023. As such, COSSEC informed that will evaluate such plans within six months. By issuing a circular letter to establish the six-month term to review the capitalization plans required in Article 6.02(a)(3) of Act 255-2002 or amending the Regulation No. 7051, COSSEC would be required to make a final decision about capitalization plans previously requested of insolvent and undercapitalized cooperatives within six months. COSSEC's final decision concerning capitalization plans could be (a) if the insolvent and undercapitalized cooperative reaches and effectively sustains 8% of the indivisible capital, then the capitalization plan is approved or (b) if the insolvent and undercapitalized cooperative does not reach or effectively does not sustain 8% of the indivisible capital, then COSSEC will proceed with a corrective action that could include sales of assets and liabilities, liquidation, involuntary merger, or voluntary merger.

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 currently or in the previous two years to a cooperative regulated by COSSEC
- Members should not have any 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 affiliated currently or in the previous two years 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. Until legislation is approved to reform COSSEC governance, the Government and COSSEC must implement a PCA protocol by developing an internal process within COSSEC (circular letter) that requires COSSEC to make a final decision within six months about capitalization plans previously requested of insolvent and undercapitalized cooperatives.

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. Also, under RAP, dividend payments are considered part of the capital instead of being treated as an interest expense. This results in an overestimation of solvency and capital base. The "CPA audited statement" of financial cooperatives includes a disclaimer with information about the difference between RAP and GAAP and the monetary adjustment resulting from it.

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 and COSSEC must submit and enact legislation during the current Ordinary Session to require all cooperatives to convert their accounting books and adhere to GAAP by June 2028. Until legislation is approved, the Government and COSSEC must implement cooperatives' RAP to GAAP transition through an internal process such as the issuance of

circular letters or amendments to Regulations No. 8664 and 8665. 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.

COSSEC must consider implementing other initiatives to promote the transition from RAP to GAAP while legislation is approved, such as amendment of Regulation No. 8664 and 8665, issuance of circular letters, and modifications to internal database systems to reflect changes in GAAP accounting. Although a considerable number of the financial cooperatives already post their "CPA audited statements" on their internet site, COSSEC should issue a circular letter requiring all financial cooperatives to post their "CPA audited statements" on their own internet site and should provide a compliance report to the Oversight Board every year. Refer to Exhibit 23 for details of the 2023 CCFP COSSEC reporting requirements.

Implementation measures to transition from RAP to GAAP must include:

EXHIBIT 14: RAP TO GAAP TRANSITION TIMELINE

Implementation action	Date
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 2028
While legislation is approved, COSSEC must issue circular letters to amend Regulations 8664 and 8665.	Widespread implementation by June 2028
Implement accounting standard codification ("ASC") 320-10-35 ("Debt securities") from GAAP	All cooperatives by June of 2028
Implement ASC 320-10-35-20 ("CUSIP" or Committee of Uniform Security Identification Procedures") from GAAP	All cooperatives by June of 2028
Implement ASC 320-10-35-30 (Evaluate Whether an Impairment Is Other Than Temporary) from GAAP	June of 2028

Improved supervisory interventions

To prevent the increase in 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 corresponding actuarial risk level priorities under RAP accounting and their corresponding CAEL classification. Refer to Exhibit 23 for details of the 2023 CCFP COSSEC reporting requirements.**

Moreover, if there is a change in the actuarial risk priorities of a cooperative that was previously classified as insolvent, but that still represents a risk for the COSSEC Insurance Fund in terms of its undercapitalization, COSSEC should consider incorporating the CAMEL indicator as part of its assessment. CAMEL is a financial indicator based on Regulation No. 7790. CAMEL indicator stands for: "C" as capital, "A" assets, "M" management capacity, "E" earnings, and "L" liquidity. CAMEL parameters of financial evaluation include: "1" as excellent, "2" good, "3" average, "4" deficient and "5" as critical.

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 informal 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 to the cooperative's asset level, but it typically should not exceed 15 business days.

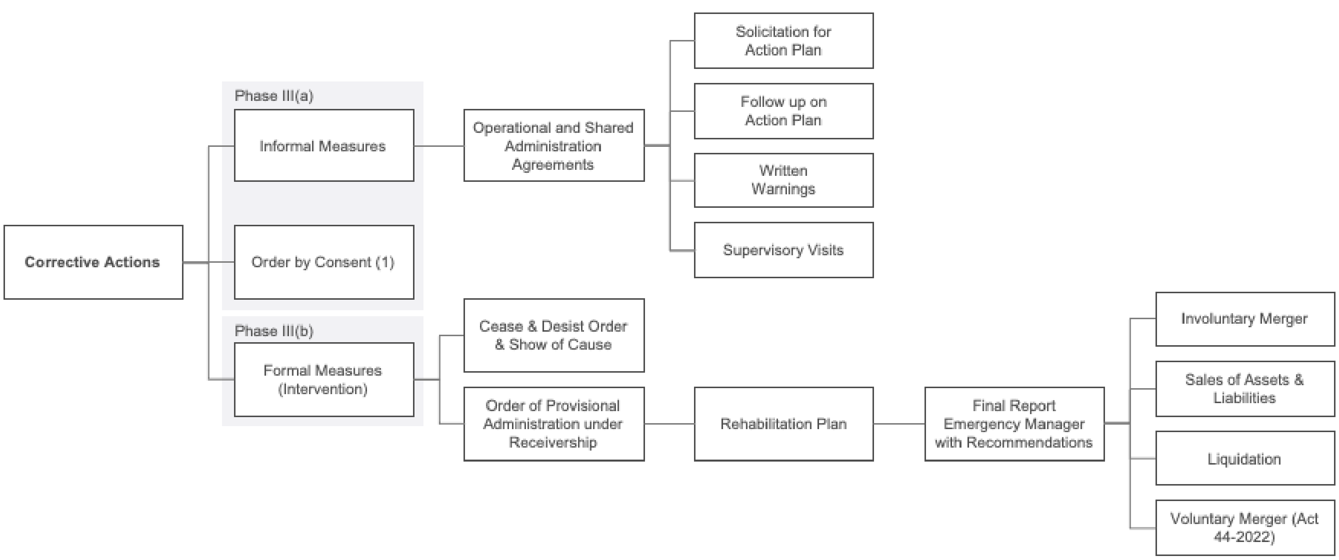
When COSSEC determines that the financial standing of a cooperative is no longer sustainable and that COSSEC therefore needs to intervene, it should place the cooperative into receivership.

COSSEC managers should next generate a rehabilitation plan for the cooperative in question and then prepare a final report with recommendations of 4 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 assets cannot satisfy the cooperative's debts and when there are no prospective investors to which the cooperative can be sold.
- Voluntary merger among solvent and insolvent cooperatives with COSSEC assistance pursuant to Act 44-2022

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's 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 15: 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, liquidation, involuntary merger, or voluntary merger among solvent and insolvent cooperatives with COSSEC assistance pursuant Act 44-2022, 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 Insurance Fund's cost
- Solvent cooperative's indivisible capital
- 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 16: TIMELINE OF A TYPICAL RESOLUTION PROCESS

Phase	Goal	Milestone	Day (1-90)
Corrective actions (contd...)	Issue Order of Provisional Administration under Receivership	COSSEC Examiner to Issue preliminary Rehabilitation report	71 to 80
	Generate Rehabilitation Plan	COSSEC Examiner and COSSEC Management to generate final Rehabilitation plan for at-risk Cooperative	81 to 85
		Generate final rehabilitation plan	86 to 90
		Inform at-risk cooperative of final resolution (P&A, Involuntary Merger, Liquidation)	
	Rehabilitation plan key steps (Liquidation, P&A, Involuntary Merger, or Injection Plan)	Conduct due diligence on intervened cooperative	91 to 120
		Conduct liquidation basis financial audit	
		Identify Coop's & Non-Coop's Partners P&A Transaction	
		Data Room for Evaluated Partners	
		Due diligence and bidders' process	
		Identify possible acquisition partners	
		Evaluation of proposals	
		COSSEC to notify final decision to FOMB and AAFAF	
		Conduct transaction	

Phase	Goal	Milestone	Day (1-90)
Identification of cooperatives at risk	Identify cooperatives at risk	Conduct actuarial analysis to classify cooperatives into 4 priority levels	Complete
Risk evaluation	Conduct CAELS examination	COSSEC examiner to analyze at-risk cooperative's capital adequacy, assets, earnings, liquidity and sensitivity	1 to 15
	Generate risk examination report	Identify capital conditions of at-risk cooperative	16 to 30
		Identify liquidity condition of at-risk cooperative	
		Determine ability to continue of operations a of at-risk cooperative	
Corrective actions	Take Informal Meassures	COSSEC Management to determine which informal measure to be taken (solicitation for action plans, follow up action plans, written warnings, supervisory visits)	31 to 35
		Inform at-risk cooperative's BOD of informal measure taken	
		Cooperative to comply with informal measure taken	
	Determine Formal Measure to be taken	COSSEC Management to determine if Cease and Desist Order will be Issued or if cooperative will automatically be placed on receivership	36 to 40
	Issue Cease and Desist Order	COSSEC management determines Cease and Desist Order is required	41 to 45
		Administrative hearing with he COSSEC official examiner, the COSSEC lawyer and/or management, and the insolvent cooperative's lawyer and/or management	46 to 55
		Official examiner to issue a final report to determine if at-risk cooperative will be placed on receivership	56 to 70

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

EXHIBIT 17: EXTENDED INTERVENTION CALENDAR UNTIL JUNE 2025

Stage	Milestone	Date
First round of remedial actions (6-months)	COSSEC to initiate corrective action process for cooperatives	July-December 2021
	COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	September 2021
	COSSEC to have end-of-round debrief meeting with FOMB team to report progress on cooperatives under corrective action and outline lessons learned	December 2021
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
Fourth 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 meeting with FOMB team to report decision on capitalization plans	June 2023
Stage	**Milestone**	**Date**
Fifth round of remedial actions (6-months)	COSSEC to continue with corrective action process for cooperatives, applying lessons learned from first round of remedial actions	July-December 2023
	COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	September 2023
	COSSEC to have end-of-round debrief meeting with FOMB team to report progress on cooperatives under corrective action and outline lessons learned	December 2023
Sixth 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 2024
	COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	March 2024
	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 2024
Seventh 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 2024
	COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	September 2024
	COSSEC to have end-of-round debrief meeting with FOMB team to report cooperatives under corrective action intervention progress and outline lessons learned	December 2024
Eighth 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 2025
	COSSEC to have mid-round touch-point with FOMB to report on corrective action progress	March 2025
	COSSEC to have a closing meeting with FOMB team to report on all cooperative corrective action processes	June 2025

Chapter 6. Measures to build COSSEC's resources

COSSEC should prepare for all contingencies such as liquidity risk that could potentially end in a run-off of client deposits and shares due to a perceived lack of confidence in the strength of the cooperative system (reputational risk). 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 (in millions) that could be tapped into include US Agencies bonds $89.1, US municipal bonds $87.2, US corporate bonds $85.0, US Treasury bonds $27.1 and MBS $14.5.

As part of considering short-term financing options, COSSEC needs to constantly measure and control the impact of the interest-rate risk within the market value of the COSSEC Insurance Fund and COSSEC financial statements. The risk management report included in this CCFP will include a stress 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). COSSEC also needs to determine the cost and benefit of selling part of its insurance fund that has unrealized profits in comparison to other options that include an interest expense such in the case of a credit line.

Credit from financial institutions

Another potential alternative permissible under this 2023 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. COSSEC, as a covered entity, is required to obtain approval from the Oversight Board before proceeding with any transaction that could have a material effect on the financial condition of COSSEC.

As part of its routine contingency planning sustainability, **the Government and COSSEC must submit an updated plan showing how they would ensure adequate funding for COSSEC under the scenarios explored in Chapter 4 by the cooperatives with their respective accounting adjustments. Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.**

Long-term financing

In the longer term, Government 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, Government should consider increasing cooperatives' regular premiums by July 2026 to offset the effect of the COSSEC 5 Year Financial Projections of increasing expenditures, decreasing net revenue, lower capitalization of the COSSEC Insurance Fund (see Exhibit 21 and 22), and limiting the full potential of this milestone (COSSEC Resources), along with the milestones of supervisory interventions and financing (see Exhibit 13).

To increase premiums in the long term, COSSEC may 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. 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.

As result of the 2022 CCFP, COSSEC submitted a feasibility study that maintained the *status quo* of insurance premiums. However, COSSEC actuary under contract has agreed to an amendment to Act 114-2001 that would require a minimum "designated ratio" of audited net worth to insured shares and deposits of 1.35 per cent of total insured shares and deposits. If the "designated ratio" falls below that limit, COSSEC would be required to prepare a restoration plan to recapitalize the COSSEC Insurance Fund to its required minimum level, but with the exclusion of the pro-rata equity ratio adjustments.

Based on the previous analysis**, the Government and COSSEC must submit legislation to amend Act 114-2001 to implement the minimum "designated ratio" of audited net worth to insured shares and deposits of 1.35 per cent of total insured shares and deposits.** 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). Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.
- Actuarial study of the indicated loss reserve (required by Act 114-2001). Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.

Chapter 7. Other measures to strengthen COSSEC and the cooperative system

Nearly three years ago, the Government of Puerto Rico committed to reforming 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.

Focusing supervision resources on financial cooperatives

Under the current structure, COSSEC is the regulating entity for both financial (102) 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

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

- Increasing the long-term cost of the COSSEC Insurance Fund because of these delayed corrective actions.

COSSEC examiners' workload relative to financial cooperatives has been decreasing. The number of examiners increased during the 2022 CCFP period as result of COSSEC recruitment efforts and decreased in the 2023 CCFP due to attrition, while the number of financial cooperatives decreased to 102 cooperatives due to the implementation of the milestone of supervisory interventions. As result, the ratio of financial cooperatives to examiner was reduced from 3.1 in the 2021 CCFP to 2.8 in the 2023 CCFP. The ratios of non-financial cooperatives to examiner and total cooperatives to examiner (financial and non-financial) increased during 2023 CCFP from 4.0 to 4.3 and from 6.9 to 7.1, respectively, based on the available information of non-financial cooperatives.

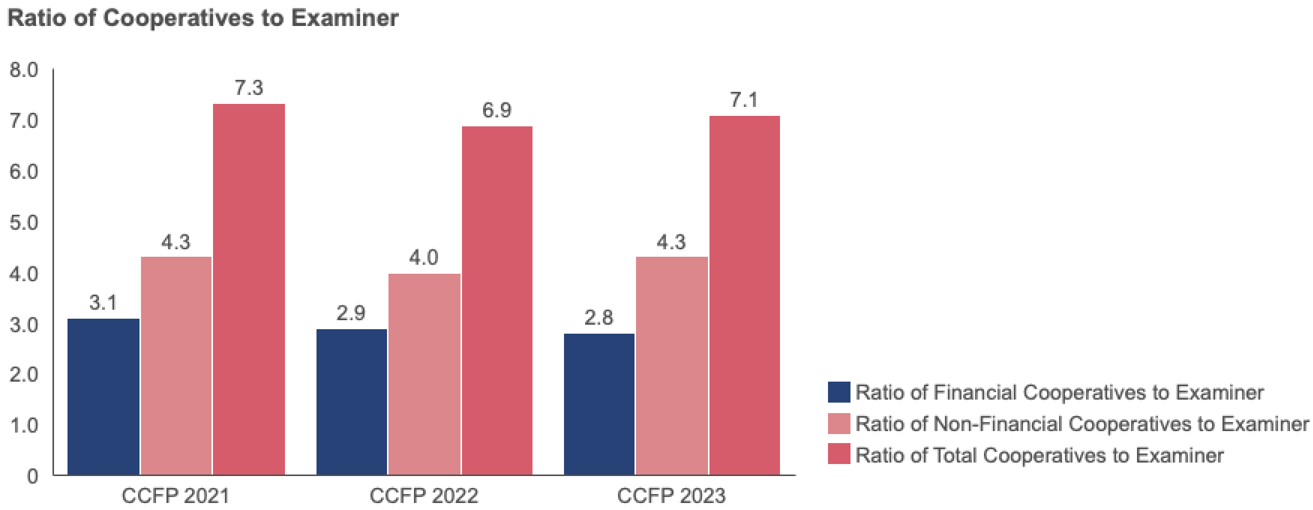
EXHIBIT 18: COOPERATIVES & EXAMINERS

Cooperatives, Examiners & Ratio	CCFP 2021	CCFP 2022	CCFP 2023
Non-Financial Cooperatives	153	153	153
Financial Cooperatives	111	109	102
Total Cooperatives	264	262	255
COSSEC Examiners	36	38	36
Ratio of Financial Cooperatives to Examiner	3.1	2.9	2.8
Ratio of Non-Financial Cooperatives to Examiner	4.3	4.0	4.3
Ratio of Total Cooperatives to Examiner	7.3	6.9	7.1

On January 2022, legislation (Senate Bill 715 or "SB 715") 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 must continue to promote the prompt enactment of such legislation.

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 19: RATIO OF COOPERATIVES TO EXAMINER



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 should 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 (like 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.
- COSSEC Insurance Fund will be headed by an executive director under COSSEC Board of Directors and will not report to the COSSEC's executive director.

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.

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.

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 the Oversight Board 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 submit an Updated Report for the Transformation Management Office**. Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.

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, the TMO has continued performing according to the Fiscal Plan objectives in terms of meeting regularly to discuss and assess matters related to the insolvent cooperatives and has complied with the submission of the updated report of the TMO and the status report of the capitalization plans for insolvent and undercapitalized cooperatives. 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's 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:

- Continued delay of the CCFP's milestones;
- Compromised the financial resources of solvent cooperatives participating in bidding processes; and
- 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.

As result of the 2022 CCFP, the TMO report reveals that COSSEC expects to complete the revision of the 13 capitalization plans for insolvent and undercapitalized cooperatives by June 2023.

COSSEC and its TMO must submit a report of the COSSEC's final decision with respect to the capitalization plans for insolvent and undercapitalized cooperatives. Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.

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 phases 2 and 3 of intervention.

Furthermore, to efficiently reform the system, COSSEC staff should intervene in the cooperatives in the most efficient way possible. As mentioned in previous fiscal plans, 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 to permanently address critical needs or should transfer them out of COSSEC so that their positions at COSSEC become available to new recruits.
- 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 102 financial cooperatives suggests a cooperatives-to-examiners ratio of 2.8. When 153 non-financial cooperatives are considered for a total of 255 cooperatives, the cooperatives-to-examiners ratio is 7.1. The increase of cooperatives-to-examiner ratio from 2.8 to 7.1 (154%), when considering non-financial cooperatives, represents an extraordinary workload for COSSEC's Examination Area, which includes not only the examiners, but also supervisors and

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

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 20: INTERVENTIONS AND HUMAN CAPITAL NEEDS

COSSEC human capital needs per cooperative under corrective actions

Context

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	Assets ($)
Small	<20M
Medium	20M-60M
Large	>60M
Total	

Approach

Corrective action processes staff needs and required dedication have been defined based on cooperative size and phase of corrective action process

	Examiners		IT		Lawyers	
	Phase 2	Phase 3	Phase 2	Phase 3	Phase 2	Phase 3
Small	2	2	1	1	1	0
Medium	3	3	1	1	1	0
Large	4	4	1	1	1	0

Dedication requirements vary for each position

- 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, the Oversight Board required that COSSEC 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, while also maintaining current employer contribution levels for those employees and dependents with pre-existing conditions (as per Law 26-2017). COSSEC has reported that 94% of its employees possess pre-existing conditions and that the average contribution for health insurance is $563.

Technology enabling the cooperative 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 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 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)[25]. 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 Government and COSSEC should consider provide 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.

Cyber-security controls

A variety of cyber security solutions is required to mitigate cyber risk considering that cyberattacks are becoming more common and sophisticated and cooperative networks are growing more complex. Without increased support and oversight, cooperatives are more vulnerable to cyberattacks. As such, COSSEC **must**

---

[25] World Bank. (2021). Share of the population using the Internet, 2019. https://ourworldindata.org/grapher/share-of-individuals-using-the-internet

ensure that cooperatives routinely perform <u>vulnerability test and penetration test.</u> COSSEC must also provide recommendations of "cost effective course of actions" for those cooperatives that lack adequate testing mechanism to prevent cyberattacks. COSSEC must provide every year a compliance report within 90 days after the calendar year end. Refer to Exhibit 23 for details of 2023 CCFP COSSEC reporting requirements.

Financial projections and required reporting

2023 COSSEC Fiscal Plan pursuant to PROMESA Section 201(e)

Part III: Financial projections and required reporting

Chapter 8. COSSEC 5 Year Financial Projections

EXHIBIT 21: FY23-FY28 EXPENSE SUMMARY

COSSEC Expenditures Projections

000s		FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Pre-measures expenditures	Provision for Known Losses	$0	$0	-$5,000	-$5,000	-$5,000	-$5,000
	Employee Compensation and Benefits	-$7,318	-$9,869	-$9,940	-$10,080	-$10,220	-$10,440
	General and Administrative Expenses	-$3,185	-$3,968	-$4,060	-$3,920	-$3,780	-$4,060
	Total expenditures	**$10,503**	**$13,837**	**$19,000**	**$19,000**	**$19,000**	**$19,500**
OPEX measures	Total OPEX measures	$0	$0	$0	$0	$0	$0
Payroll measures	Total Payroll measures	$0	$0	$0	$0	$0	$0
Budgetary Reserves	Milestone Reserve	$400	$400	$400	$400	$400	$400
Post-measures expenditures	**Post-measures expenditures**	**$10,903**	**$14,237**	**$19,400**	**$19,400**	**$19,400**	**$19,900**

EXHIBIT 22: COSSEC 5-YEAR PROJECTIONS

COSSEC 5-year projections

000s		FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Revenues	Coop's Regular Premiums[1]	$25,885	$26,000	$26,000	$26,000	$26,000	$26,000
	Interest income	$11,276	$9,935	$11,419	$11,690	$12,350	$13,621
	Other revenue	$0	$0	$0	$0	$0	$0
	Total operating revenues[2]	**$37,161**	**$35,935**	**$37,419**	**$37,690**	**$38,350**	**$39,621**
Post-measures expenditures	**Post-measures expenditures**	**$10,903**	**$14,237**	**$19,400**	**$19,400**	**$19,400**	**$19,900**
Net	**Net**	**$26,258**	**$21,698**	**$18,019**	**$18,290**	**$18,950**	**$19,721**
Expenditures to premiums ratio	**Expenditures to premiums ratio[3]**	**0.41**	**0.53**	**0.54**	**0.54**	**0.54**	**0.56**
CIF to premiums ratio	**CIF to premiums ratio[4]**	**0.59**	**0.47**	**0.46**	**0.46**	**0.46**	**0.44**

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.
3. Employee compensation and benefits plus general and administrative expenses divided into Coop's regular premiums or the proportion of the Coop's regular premiums used for COSSEC's expenditures (without the provision for known losses).
4. 1 less the expenditure to premiums ratio or the proportion of the Coop's regular premiums that could be used as new money for the COSSEC Insurance Fund (CIF).

Expense measure

In FY24, COSSEC must implement the following measure:

Milestone reserve: The 2023 CCFP recognizes the significant effort needed to make progress on the requirements of this Fiscal Plan. As such, the 2023 CCFP continues to include approximately $400,000 in funds that are conditioned on the achievement of the milestones of changes in governance, increasing transparency in accounting, and improving supervisory interventions. Upon achievement of the milestones, the Oversight Board and the Governor shall work with COSSEC to amend the budget to authorize the expenditure of the ~$400,000.

Revenue challenges

From FY25 to FY28, COSSEC will face the following revenue challenges:

- COSSEC's financial projections include a reduction in COSSEC net income (see Exhibit 22), due to an increase in total expenditure excluding the provision for known losses and decrease in cooperatives' regular premiums.
- Unless there is an increase in cooperatives' regular premiums sufficient to offset the increase in expenditures excluding provision for losses (from 41% to 56% of the cooperatives' regular premiums), the capitalization of the COSSEC Insurance Fund will decrease (from 59% to 44% of the cooperatives' regular premiums).
- COSSEC's financial projections could pose a challenge to fulfill the 2023 CCFP milestones of supervisory interventions, financing, and COSSEC's resources.

Chapter 9. Required reporting

COSSEC must report the following items to the Oversight Board:

EXHIBIT 23: COSSEC REPORTING REQUIREMENTS

Area	Reporting Requirement	Closing the 1st reporting period	Cadence for FOMB Reporting	Cadence for Public Reporting	Reporting Requirement Source
Budget reporting	Budget Breakdown	1-Jul	Monthly	N/A	Budget
	Certified Budget	1-Jul	Monthly	N/A	Budget
	Budget to Actual	1-Jul	Monthly	N/A	Budget
	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 updated	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

Area	Reporting Requirement	Closing the 1st reporting period	Cadence for FOMB Reporting	Cadence for Public Reporting	Reporting Requirement Source
COSSEC Insurance Fund reporting	Principal Cash Flow	1-Jul	Monthly	N/A	Fiscal Plan
	Interest Cash Flow	1-Jul	Monthly	N/A	Fiscal Plan
	Yield to Maturity	1-Jul	Monthly	N/A	Fiscal Plan
	Average Coupon	1-Jul	Monthly	N/A	Fiscal Plan
	Modified Duration	1-Jul	Monthly	N/A	Fiscal Plan
	Effective Duration	1-Jul	Monthly	N/A	Fiscal Plan
	Credit Rating (S&P, Moody's or Fitch)	1-Jul	Monthly	N/A	Fiscal Plan
	Cash Balance	1-Jul	Monthly	N/A	Fiscal Plan
	Market Value	1-Jul	Monthly	N/A	Fiscal Plan
	Amortized Cost	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
	Repeal of article 11.02 (d) of Act 220-2015 and amendment of section 7.02 of Act 255-2002	1-Jul	Monthly	Monthly	Fiscal Plan

Area	Reporting Requirement	Closing the 1st reporting period	Cadence for FOMB Reporting	Cadence for Public Reporting	Reporting Requirement Source
Stakeholder engagement reporting	Meetings with Liga de Cooperativas	1-Jul	Monthly	Monthly	Fiscal Plan
	Meetings with G25	1-Jul	Monthly	Monthly	Fiscal Plan
	Meetings between COSSEC and AAFAF	1-Jul	Monthly	Monthly	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

Area	Reporting Requirement	
Stakeholder engagement reporting	Updated Roster of All Cooperatives	40 days after certification of the 2023 COSSEC Fiscal Plan
	Plan Showing Adequate Funding for COSSEC	60 days after certification of the 2023 COSSEC Fiscal Plan
	Risk Management Report of the CIF	90 days after certification of the 2023 COSSEC Fiscal Plan
	Risk Assessment Report of the BCPR	90 days after certification of the 2023 COSSEC Fiscal Plan
	Actuarial Study for the Insurance Premium Rates	120 days after certification of the 2023 COSSEC Fiscal Plan
	Actuarial Study for the Loss Reserve	120 days after certification of the 2023 COSSEC Fiscal Plan
	Updated Report of the TMO	140 days after certification of the 2023 COSSEC Fiscal Plan
	Status Report of the Capitalization Plans	140 days after certification of the 2023 COSSEC Fiscal Plan
	Compliance Report of Cooperatives CPA Audited Financial Statements on their Internet Site	148 days after certification of the 2023 COSSEC Fiscal Plan
	Report of the Cooperatives Cross Deposits	180 days after certification of the 2023 COSSEC Fiscal Plan
	Status Report of the Level of Cybersecurity	190 days after certification of the 2023 COSSEC Fiscal Plan

In addition, any interventions in cooperatives with financial concerns must be consistent with this 2023 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 2023 CCFP because they are typically not the option with the lowest long-term cost to the Insurance Fund.

Chapter 10. Conclusion

The 2023 CCFP is focused on maintaining the financial stability of COSSEC and the cooperative system in Puerto Rico, ensuring that the system's 1.1 million cooperative 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, the restrictive monetary policy by the US Federal Reserve to curb inflation with nine consecutive increases in the interest rate, and the vulnerability of the financial system after the sudden collapse of the Silicon Valley Bank (SVB) in 48 hours due to a run on its deposits (as well as the recent experiences of other banks) will pose heightened challenges for COSSEC and cooperatives. This "new normal" will also set the stage for cooperatives to serve the communities of Puerto Rico in new dimensions. The 2023 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, 2021 and 2022 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 2023 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 bright.

Appendix

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 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 billion[26]), 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&Ls' floating-rate funding and fixed-rate income only worsened, 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 ~$130B[27].

Despite the government's initial response to the crisis, a 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) with 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.

[26] Federal Reserve. (2020). *Federal Reserve History*. Retrieve from: https://www.federalreservehistory.org/
[27] Federal Reserve. (2020). *Federal Reserve History*. Retrieve from: https://www.federalreservehistory.org/

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 (unlike with 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 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) 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. 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 only on real-estate related assets; and savings banks' funding structures were bolstered by issuing senior bonds. Finally, steps were taken to fundamentally change governance in these savings banks: 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 FROB[28].

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.

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