



**DBF GUIDANCE FOR GEORGIA STATE-CHARTERED BANKS, BANK HOLDING COMPANIES, CREDIT UNIONS, AND TRUST COMPANIES**

TO: Supervision Staff

CC: Georgia State-Chartered Banks and Credit Unions

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SUBJECT: DEVELOPMENT OF POLICIES BY FINANCIAL INSTITUTIONS

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Policy formulation is a fundamental activity for all newly chartered financial institutions prior to opening for business, as well as established financial institutions. This commentary is designed to help management articulate sound flexible written policies to govern areas critical to a financial institution's success. The suggested areas of coverage for each policy discussed represent minimum recommended coverage for the policy. In all cases, financial institutions will want to expand coverage in the policy to tailor the policy to the unique needs of the institution. Also, the policies included in this commentary are not and should not be considered as the only policies that an institution needs to operate effectively. This statement is a starting point for policy formulation.

Members of the Board of Directors (Board) have a fiduciary responsibility to formulate a set of rules for their organization through written policies. The formulation of written policies offers a financial institution's directors and officers the opportunity to consider and develop basic objectives and to determine the desired institutional direction. It is the Boards' responsibility to review and revise, as necessary, approved, written policies when the strategic plan changes, when the overall condition of the institution changes, when the risk appetite changes, and periodically, but no less frequently than annually.

Creating written policies allows the Board and senior management an opportunity to reconsider the basic objectives of the financial institution as well as emphasizing to financial institution

personnel the priority that the Board and senior management give to policy areas. Therefore, the formulation of sound written policies is important. However, implementation, adherence, and regular review of the written policies are critical to the success of the financial institution's safety and soundness.

The adoption of written policies does not guarantee the financial institution's success. Financial institutions operating in a financial services environment must have sound overall strategic planning supported by flexible written policies and capable management to succeed in a highly competitive environment. These guidelines for policy development are one element of support to develop a healthy and successful operation.

## LOAN POLICY

A primary purpose of a written loan policy is to provide a framework of standards and points of reference within which individual lending personnel can operate with confidence, relative uniformity, and flexibility. Loans comprise a major portion of the asset structure of most financial institutions and it is the asset category which ordinarily presents the greatest credit risk and, therefore, potential loss exposure. A written loan policy can greatly assist management in the maintenance of proper credit standards, avoidance of unnecessary risks, and proper evaluation of new business opportunities. The lending policy should be tailored to fit the financial institution's specific needs, staff, and objectives. The financial institution's objectives for the lending function should include safeguarding of assets, earnings performance, liquidity, and asset/liability management.

Establishment of a lending policy is particularly important in newly organized financial institutions where management and staff are often unacquainted with each other or unfamiliar with the operations of the financial institution. The actual drafting of the policy may be delegated to the chief executive officer and the lending staff, but the Board should have a role in the process, either by reviewing and approving the policy once formulated or by direct participation at critical points in the drafting process. While it is not suggested that the written loan policy should actually be written by the Board, it should be approved by them, and not in a cursory or perfunctory manner, but rather after careful explanation, consideration, and discussion.

A constructive starting point in establishing a written loan policy is the careful evaluation and coverage, at a minimum, of the following points:

1. A description of the general fields of lending in which the financial institution shall engage, the type of loans and collateral considered desirable, and the types of loans and collateral considered undesirable.
2. An identification of the geographical trade area from which financial institution loans should be generated, circumstances under which loans outside the trade area may be granted, and processes for approving loans outside the trade area.
3. The financial institution's legal lending limits and other legal constraints should be set forth to avoid inadvertent violations of financial institution laws and regulations. In addition to traditional loans, these limits should be calculated to include continuing obligations for Other Real Estate Owned, overdrafts, cash items in process of collection, and certain recourse obligations.
4. The responsibility of the Board in reviewing and approving loans and periodically reviewing major lines of credit.

5. The lending authorization limits (secured and unsecured) of a loan or executive committee, if any, and each loan officer. These authorities should be approved at least annually, for each individual by written resolution of the Board and kept current at all times.
6. The guidelines under which unsecured loans will be granted.
7. The guidelines for rates of interest and terms of repayment for (i) unsecured loans and (ii) secured loans.
8. Limitations on the amount of secured loans that will be made in relation to the market value of the collateral or security pledged, and an identification of the types of supporting documentation required by the financial institution for each type of secured loan.
9. The maintenance and review requirements for complete and current credit and collateral files on each borrower.
10. Appropriate and adequate collection procedures, including but not limited to, the action to be taken against borrowers who fail to make timely payments.
11. Guidelines establishing limitations on the maximum dollar volume of loans in relation to types of funding sources. This includes assets or deposits of the financial institution based on seasonal demands and loan mix or an established level of loans by type; i.e., commercial, consumer, term, etc. Also, management's plans for monitoring and taking appropriate corrective action, if deemed necessary, on any concentration that may exist.
12. Specific guidelines governing loans to employees, officers, and directors of the financial institution, including a prohibition against recurring overdrafts or cash items held against deposit account of the employees, officers, directors, or other insiders of the financial institution (see prohibition of Federal Reserve Regulation O).
13. Appropriate limitations on the extension of credit through overdrafts.
14. A prohibition against (a) the addition of uncollected interest on the unpaid balance of any loan on which such interest is due, (b) the acceptance of a separate note for uncollected interest due on any loan unless supported by additional tangible collateral which adequately and completely secures the loan, (c) the continuation of accrual of interest on any loan delinquent in principal or interest payments 90 days or more, or (d) any other device that essentially avoids recognition of overdue loans and/or artificially inflates the income of the financial institution.

15. The guidelines under which uncollectible and seriously past due loans will be charged-off.
16. Establishment of an allowance for loan and lease losses (ALLL) by the Board which will be maintained against the reasonable risk inherent in the lending operation based on a quarterly review of the loan portfolio and the financial institution's loan volume.
17. Exact definition of a borrower's total liability to the financial institution.
18. Plans as to how exceptions will be identified and treated.
19. Limitations on the maximum dollar volume of loans in relation to total assets and total liabilities.
20. Guidelines for obtaining, reviewing, and ordering appraisals and evaluations, when needed.
21. Guidelines addressing the financial institution's loan review and grading system ("Watch list").
22. Plans to create, produce, and review related debt reports that aggregate all obligations of a single borrower to the financial institution including personal and business debt, obligations remaining from Other Real Estate Owned, overdrafts, cash items in process of collection, full and limited guarantees, and recourse obligations.

After adoption of a written loan policy, the administration of the policy is the responsibility of the Board. Procedures should be implemented to determine compliance with the loan policy. It is most important that the loan policy be adaptable to changing economic conditions, balance sheet management considerations, the financial institution's financial position, and competitive conditions.

### Credit Grading Systems

Accurate and timely credit grading is a primary component of an effective loan review system and should be thoroughly addressed in the loan policy. Credit grading involves an assessment of credit quality, the identification of problem loans, and the assignment of risk ratings. An effective system provides information for use in establishing valuation allowances for specific credits and for the determination of an overall ALLL level.

Credit grading systems often place primary reliance on loan officers for identifying emerging credit problems. Given the importance and subjective nature of credit grading, a loan officer's judgement regarding the assignment of a particular credit grade should

generally be subject to review. Reviews may be performed by peers, superiors, or loan committee(s), or by other internal or external credit review specialists. Credit grading reviews performed by individuals independent of the lending function are preferred because they often provide a more conservative assessment of credit quality. A credit grading system should, at a minimum, include the following:

1. A formal credit grading system that can be reconciled with the framework used by regulatory authorities;
2. An identification of loans or loan pools that warrant special attention;
3. A mechanism for reporting identified loans, and any corrective action taken, to senior management and the Board; and
4. Documentation of an institution's credit loss experience for various components of the loan and lease portfolio.

A tool used in this regard is the establishment of loan review and grading systems.

#### Loan Review Policy and System

Management should maintain written policies and procedures governing the loan review system. These should be reviewed and approved at least annually by the Board. The term loan review system refers to the responsibilities assigned to various areas such as credit underwriting, loan administration, problem loan workout, independent and ongoing credit review, or other areas. The complexity and scope of a loan review system will vary based upon an institution's size, type of operations, and management practices. Although, smaller institutions may not be expected to maintain separate loan review departments, it is essential that all institutions maintain an effective loan review system.

Regardless of its complexity, an effective loan review system is generally designed to address the following objectives:

- To promptly identify loans with well-defined credit weaknesses that warrant the special attention of management so that timely action can be taken to minimize credit loss;
- To provide essential information for determining the adequacy of the ALLL;
- To identify relevant trends affecting the collectability of the loan portfolio and isolate potential problem areas;
- To evaluate the activities of lending personnel;
- To assess the adequacy of, and adherence to, loan policies and procedures, and to

monitor compliance with relevant laws and regulations;

- To provide the Board and senior management with an objective assessment of the overall portfolio quality as well as actions taken by management; and
- To provide management with information related to credit quality that can be used for financial and regulatory reporting purposes.

The loan review policy should include a written description of the overall credit grading process and establish responsibilities for the various loan review functions. Loan review may be implemented by a qualified external party, auditor, loan review officer, or a loan review committee who should report directly to the Board. The nature, scope and structure of loan review and grading systems will vary with the size and complexity of each financial institution; however, the loan review policy should generally address the following items:

1. **Qualifications of loan review personnel:** Qualifications should be based on level of education, experience, and extent of formal training. In addition, they should be knowledgeable of pertinent laws and regulations that affect lending activities, sound lending practices, and their own institution's specific lending guidelines.
2. **Independence of the review personnel:** Management should ensure that all loans that are included in the loan review are reviewed by individuals that are independent of the loans under review, including the underwriting, administration, and approval processes.
3. **Frequency of reviews:** The loan review function should provide feedback on the effectiveness of the lending process in identifying emerging problems. Reviews of significant credits should be performed annually, upon renewal, or more frequently when factors indicate a potential for deteriorating credit quality. Additionally, a sampling of loans with balances below the significant credits should be reviewed in tiers throughout the year to assess the quality of other segments of the loan portfolio, specifically addressing weak or negative trends that may be pervasive throughout a particular loan type.
4. **Scope and depth of reviews:** The scope and depth of the review should include not only a review of specific loans, but also a review of the entire credit administration process. The annual review program should cover significant loans and other loans to result in a percentage of the loan portfolio that can be reasonably extrapolated to capture the overall risk exposure of the loan portfolio. The scope should include analysis of credit quality, the sufficiency of credit memoranda and collateral documentation, completeness of the lien perfection, appropriateness of and compliance with internal policies and procedures as well as applicable laws and regulations, the accuracy and timeliness of assigned credit grades, and the effectiveness of the institution's internal controls, approval processes, tickler systems, and exception tracking reports.

5. Review of findings and follow-up: Loan review findings should be reviewed with appropriate loan officers, department managers, and members of senior management. Any existing or planned corrective action should be elicited for all noted deficiencies. All deficiencies that remain unresolved should be reported to senior management and the Board.
6. Maintenance of workpapers: Workpapers for loans reviewed should consist of documentation supporting assigned ratings.
7. Board reporting: Timely reports should be prepared and submitted to the Board that summarizes the results of the loan review. Deficiencies should be addressed and remedied in a prompt manner.

### Environmental Risk and Lender Liability Program

A growing area of potential risk associated with lending is the potential for liability under various environmental laws and claims of lender liability by borrowers, and possibly other creditors and shareholders. The potential adverse effect of environmental contamination on the value of real estate collateral and the potential for liability have become important factors in the evaluation of real estate transactions and making loans secured by real estate. The Environmental Protection Agency (EPA) has responsibility for enforcement authority of environmental laws. The EPA may be contacted for information or exemptions available to financial institutions regarding liability and cleanup of contaminated property. Legislation and the authority of the EPA are still evolving regarding liability of financial institutions as lenders holding a security interest in contaminated property. In order to minimize the financial institution's exposure when holding a security interest in real or personal property that may be in violation of Federal or State environmental laws, and when making loans to borrowers who engage in a potentially environmentally sensitive business, the following should apply to all real estate loans in which the financial institution has a security interest or owns outright through foreclosure, with the exception of single family residences:

1. Procedures: When taking a loan application from the borrower, the loan officer should make a determination as to whether or not the borrower is involved in any way with the use of hazardous substances. The financial institution should develop and maintain a list of such businesses which may engage in a potentially environmentally sensitive activity. The financial institution should establish guidelines for actions to be taken when a borrower is suspected to engage in a business that uses hazardous substances.
2. Risk Assessment: If it is determined that the borrower may be involved in a potentially hazardous industry or business, the loan officer should follow established procedures such as a Preliminary Environmental Risk Review. After completing the assessment, a determination must be made as to whether or not an environmental risk audit by an outside firm should be ordered and performed prior to making the loan to the potentially hazardous business.



3. Documentation: When closing a loan which is secured by real property of a potentially hazardous business, the customer should execute an indemnity and hold harmless covenant. This document should be attached to the Security Deed.
4. Managing the Loan: Under existing Federal and State laws, the financial institution may have an exemption from environmental liability as the holder of a security interest in the real property collateral as long as the financial institution's actions involved with the customer do not constitute "participating in the management" of the business. The financial institution should not exercise any decision-making control over the borrowers' environmental compliance obligations. Also, the financial institution should not take any responsibility for all, or substantially all of, the operational aspects of the borrower's enterprise.

### Lender Liability Risk Management

Financial institutions should address procedures in the written loan policy to manage the risk of lender liability through file documentation and loan administration practices. Claims of lender liability usually involve problem workout and collection loans. Memoranda in the loan file should detail the various terms of the credit and any agreements reached with potential borrowers. Management must be consistent in its handling of the borrower. Files should be cleansed free of extraneous materials and care should be exercised in file maintenance. The conduct of loan officer should be professional and oral agreements of any kind should be avoided, or if one is made, it should be confirmed in writing with the borrower, with a copy to the loan file. Participation by the loan officer in management of the borrowers' business or interferences in its day-to-day affairs should be avoided. All management activities should be carried out in good faith, consistently apply fair dealings, and in accordance with the terms of the loan agreement.

### Subprime Lending Program

For purposes of this guidance, "subprime lending" is defined as extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional lending customers as defined in Interagency Guidance on Subprime Lending, March 1, 1999. Institutions often refer to subprime lending by other names such as the nonprime, nonconforming, high coupon, or alternative lending market.

The term "subprime" refers to the credit characteristics of the borrower at the loan's origination, rather than the type of credit or collateral considerations. Subprime borrower typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies. These borrowers may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria.

Financial institutions should have comprehensive written policies and procedures, specific to

each subprime lending product, that set limits on the amount of risk that will be assumed and address how the institution will control portfolio quality and avoid excessive exposure. Policies and procedures should be in place before initiating the activity. Acceptable origination channels, dealers, brokers, correspondents, and marketing firms, for subprime loans should be included in written policies. Additionally, minimum regulatory capital requirements will not apply to an institution's portfolios that exhibit substantially higher risk profiles that exist in subprime loan programs. Subprime lenders should retain additional capital support consistent with the volume and nature of the additional risks assumed. These institutions are expected to establish procedures for quantifying the amount of capital needed to offset the additional risk in subprime lending activities, and for fully documenting the methodology and analysis supporting the amount specified.

Subprime lending should only be conducted within a comprehensive lending program that employs strong risk management practices to identify, measure, monitor, and control the elevated risks that are inherent in this activity. If risks associated with subprime lending activities are not properly controlled, subprime lending may be considered an unsafe and unsound practice.

The Board's decision to engage in subprime lending programs should be based on the institution's overall business strategy and risk tolerances, and with a full knowledge of all business risk issues. When establishing subprime lending programs, management should proceed slowly and cautiously. The following items are essential components of a risk management program for subprime lending:

**Planning and Strategy:** Prior to engaging in subprime lending, the Board and senior management should ensure that all involved parties have properly addressed critical business risk and issues including:

1. Evaluated costs associated with attracting and retaining qualified personnel, and investments in the technology necessary to manage a more complex portfolio.
2. Developed a clear solicitation and origination strategy that allows for after-the-fact assessment of underwriting performances.
3. Established appropriate feedback and control systems.
4. Developed a risk assessment process that extends beyond credit risk and appropriately incorporates operating, compliance, market, liquidity, reputation, and legal risks.
5. Implemented a periodic Strategic Plan performance analysis to detect adverse trends or circumstances and take appropriate action in a timely manner.

**Management and Staff:** Prior to engaging in subprime lending, the Board should ensure that senior management and staff possess sufficient expertise to appropriately manage the risks in subprime lending and that staffing levels are adequate for the planned volume of activity. Generally, it is not sufficient to have the same staff responsible for both subprime and prime loans. Staffing challenges include:

1. Subprime lending requires specialized knowledge and skills that many financial institutions do not possess.

2. Marketing, account origination, collections strategies, and techniques often differ from those employed for prime credit.
3. Servicing and collecting subprime loans can be very labor intensive and requires a greater volume of staff with smaller caseloads.
4. Compensation programs should not depend primarily on volume or growth targets; any targets used should be weighted towards factors such as portfolio quality and risk-adjusted profitability.

**Profitability and Pricing:** A key consideration for lenders in the subprime market is the ability to earn risk-adjusted yields that appropriately compensate the institution for the increased risk and costs assumed. The institution must have a comprehensive framework for pricing decisions and profitability analysis that considers the following for each product:

1. Origination, administrative/servicing, expected charge-offs, funding, and capital.
2. Fees - including the extent they are recurring and a viable source of revenue.
3. Profitability projections should be incorporated into the operating budget and business plan.
4. Method of tracking actual performance against projections regularly and a process for addressing variances.

**Loan Review and Monitoring:** The Board should adopt and implement a comprehensive analysis and information system that identifies, measures, monitors, and controls the risks associated with subprime lending.

1. The analysis must promote understanding of the portfolio and early identification of adverse quality/performance trends.
2. Systems employed must possess the level of detail necessary to properly evaluate subprime activity.
3. Analysis should take into consideration the effects of portfolio growth and seasoning, which can mask true performance by distorting delinquency and loss ratios.
4. Liquidity and funding sources for subprime lending should be reviewed and assessed periodically.
5. Management should monitor customer behavior and credit quality and take proactive measures to avert potential problems.

#### Concentrations in Real Estate Acquisition, Development and Construction Lending

Generally, an asset concentration is a significantly large volume of economically-related or collateral-related assets that an institution has advanced or committed to a person, entity, affiliated group, or industry. These assets may in the aggregate present a substantial risk to the safety and soundness of the institution. Adequate diversification of risk allows the institution to avoid the excessive risks imposed by credit concentrations. Concentrations add a dimension of risk which the Board should consider when formulating plans and policies. Elevated concentration levels require additional capital support commensurate with risk taken.

In formulating policies, management should, at a minimum, address goals for portfolio mix and

limits within the real estate acquisition, development and construction (ADC) loan categories. Management should consider the need to track and monitor the economic and financial condition of specific geographic locations, industries, and groups of borrowers in which the financial institution invests heavily.

The degree of risk in real estate loans depends primarily on the loan amount in relation to collateral value, the interest rate, and most importantly, the borrower's ability to repay in an orderly fashion. Financial institutions can jeopardize their capital structure by a concentration in ADC loans. Adverse economic conditions could result in a decline in realty values. Additional risks in concentrated ADC lending include: granting real estate loans without consideration of normal or even depressed realty values during periods of great demand and inflated price structure, the maximum debt and paying capacity of borrowers, and failure to reasonably restrict real estate loans on properties for which there is limited demand.

When real estate lending concentrations exist, the Board should adopt policies that address the following factors, at a minimum:

- Maximum amount that may be loaned on a given property, in a given category, i.e. subdivision;
- Required appraisals (professional judgments of the present and/or future value of the real property);
- Limits on residential single-family construction lending;
- Limits on number of speculative and pre-sold construction home loans granted to each builder and in each development;
- Minimum requirement for initial equity investment;
- Guidelines for support of draw requests by inspections;
- Monitor of concentrations of credit periodically;
- Information system that provide reports by loan types or repayment source for industry concentrations which include dollar volume/amount and percentages for funded and unfunded totals measured against Tier 1 Capital; and
- Limitation for specific ADC concentration.

## **LIQUIDITY AND FUNDS MANAGEMENT POLICY**

The Board should understand the nature and level of the institution's liquidity risk, establish the institution's tolerance for liquidity risk, and approve significant policies related to liquidity and funds management. The Board, or a duly elected committee of the Board, should also ensure that senior management takes the necessary steps to monitor and control liquidity risk within the parameters of Board-approved policies. Liquidity and funds management is generally the function of the Chief Financial Officer, who manages the liquidity risk in consultation with the Board or an authorized Asset Liability Management Committee (ALCO).

Liquidity represents the ability to efficiently and economically accommodate decreases in deposits and other liabilities as well as fund increases in assets. Liquidity is essential in all financial institutions to compensate for expected and unexpected balance sheet fluctuations and provide funds for asset growth. Because liquidity is critical to the ongoing viability of any financial institution, liquidity management is among the most important activities that a financial institution conducts.

Management should avoid funding concentrations, as concentrations in funding sources increase liquidity risk. Funding diversification allows management to maintain access to different funding lines and allows flexibility in selecting the appropriate funding source. Also, in times of financial distress, an institution will likely benefit from a diversified funding base.

Effective analysis and management of liquidity requires management to measure the liquidity position of the financial institution on an ongoing basis and to examine how funding requirements are likely to evolve under various scenarios, including adverse conditions. The formality and sophistication of funds management depends on the size and sophistication of the financial institution, as well as the nature and complexity of its activities. The objectives and guidelines of funds management should encompass the following:

1. Planning for Funding Gaps (Cash Flow Planning)
2. Establishing risk tolerances for individual and aggregate limits on all potentially volatile funding sources
3. Addressing funding concentrations in or excessive reliance on any single source of funding
4. Managing Net Interest Margin
5. Ensuring Liquidity
6. Performing Balance Sheet Planning (asset mix, liability mix)
7. Performing Tax Planning

## 8. Planning Financial Institution Funding

These objectives are integral parts of a funds management policy and should include appropriate risk tolerance benchmarks as established by the Board. Benchmarks and limitations should align with the institution's short- and long-term planning objectives in consideration of the risk profile of the institution, including support from earnings and capital as well as the current economic environment.

Developing forward looking assumptions through intelligent forecasting, as opposed to speculation, is essential to liquidity planning. Management must consider the effect future events are likely to have on funding requirements as well as the probability of such events occurring. All financial institutions are affected by changes in the economic climate, but sound financial management can minimize negative changes and maximize positive ones.

The Board should understand the nature and level of the institution's liquidity risk, establish the institution's tolerance for liquidity risk, and approve significant policies related to liquidity management. The Board, or ALCO, should also ensure that senior management takes the necessary steps to monitor and control liquidity risk.

Determination of the adequacy of a financial institution's liquidity position depends upon:

1. An analysis of the current liquidity position;
2. Historical funding requirements;
3. Anticipated future funding needs; and
4. Options for reducing funding needs or attracting additional funds.

A liquidity and funds management policy should generally provide guidance for forecasting liquidity needs while considering the unique characteristics of the financial institution, the Board's goals regarding asset and liability mix, desired earnings, and margins necessary to achieve desired earnings. The policy should provide guidance to identify anticipated funding needs and authorize the means available for management to meet those needs. The policy should establish responsibility for liquidity and funds management decisions and provide a mechanism for necessary coordination between the different departments of the financial institution. Strategies should be based on sound, well-deliberated projections. The Board should be satisfied that the assumptions used in the projections are valid and the strategies employed are consistent with projections.

Contingency funding plans are essential to liquidity planning. Despite senior management's efforts to provide for liquidity needs, events may unfold that negatively impact available

resources. Senior management should consider the limitations of maintaining the current, or planned, liability structure if certain funding strategies become unavailable, as rate restrictions resulting from deterioration in the overall condition of the institution. Also, funding resources from Federal agencies may be curtailed and/or eliminated based on deterioration of the overall condition of the institution and/or deterioration in qualifying assets eligible to serve as collateral. Additionally, senior management should monitor the financial condition of liquidity resources for financial deterioration to determine if correspondent institutions can be reasonably expected to provide funding. Contingency plans must be developed in consideration of funding restraints the financial institution may encounter.

Based upon the foregoing elements of liquidity, the development of a liquidity and funds management policy should include the establishment of guidelines for the following topics:

1. Periodic review of the financial institution's deposit structure, including the volume and trend of total deposits and the volume and trend of the various types of deposits offered, the maturity distribution of time deposits, rates being paid on each type of deposit, rates being paid by trade area competition, caps on large time deposits, public funds, out-of-area deposits, and any other information needed. Management should consider maturity and repricing balance sheet mismatches, anticipated funding needs, and economic and market forecasts in its liquidity planning.
2. Conveys the Board's risk tolerance and establishes target liquidity ratios such as loan-to-deposit ratio, loan-to-asset ratio, long-term assets funded by less stable funding sources, individual and aggregate limits on potentially volatile funds by type and source, liquidity ratio, or a minimum limit on the amount of short-term investments.
  - A. Internal liquidity guidelines and limits should be established in the written liquidity and funds management policy of the financial institution. Limits may be established for target core liquidity and secondary liquidity sources. Additionally, contingency plans should be established in the event that liquidity declines below established minimum levels. Target levels should allow the financial institution to operate without the need for borrowed funds to meet liquidity needs on an ongoing basis or fund operating accounts.
  - B. Management information systems that adequately measure, monitor, control, and report liquidity risk should be in place, and reports should be regularly provided to the Board and senior management. The financial institution should set target ratios to align with the operating environment and business plan.
  - C. A target loan to deposit ratio or loan to asset ratio to allow for funds to be invested in more liquid assets, to provide for reserve funds for meeting additional loan demand or asset growth, and to maximize profits while maintaining adequate liquidity. Target ratios should allow a financial institution to operate without the need for borrowed

funds on an ongoing basis. Additionally, financial institutions should monitor funding gaps through the use of cashflow analysis over a range of timeframes.

- D. Recognition of seasonal loan demand and deposit patterns. Recognition of cyclical fluctuations in cash demands, as well as deposit fluctuations, will enable the financial institution to anticipate and plan for increased cash demands.
3. An adequate system of internal controls that ensures the independent and periodic review of the liquidity management process, and compliance with policies and procedures and liquidity strategies. Monitoring compliance should include adherence and limits for managing and monitoring liquidity to ensure adequate liquidity is maintained at all times. This process should also include monitoring internal and external factors and events that could have a bearing on the institution's liquidity.
  4. When assessing the financial institution's liquidity position, management may use analytical tools such as the Uniform Financial Institution Performance Report (UBPR) ratios in concert with the institution's internal liquidity ratios on a level and trend basis. Some UBPR ratios that are relevant include:
    - a) Net Short-Term Non-Core Funding Dependence
    - b) Net Non-Core Funding Dependence
    - c) Net Loans and Leases to Deposits
    - d) Net Loans and Leases to Total Assets
    - e) Short-Term Assets to Short-Term Liabilities
    - f) Pledged Securities to Total Securities
    - g) Brokered Deposits to Deposits
    - h) Core Deposits to Total Liabilities
  5. A contingency plan that addresses alternative sources of funds if initial projections of funding sources and uses are incorrect or if a liquidity crisis arises. This plan should include scenarios of changing overall financial conditions and for varying resources available for each situation, particularly changes to capital categories for Prompt Corrective Action as certain funding sources automatically become unavailable for certain categories.
  6. Establishment and periodic testing of correspondent institution lines of credit including both unsecured and secured lines. Diversification reduces dependence on any one supplier. The financial institution should not exceed its capacity to borrow in any one area or market. A limit should be set for each category of borrowing.
  7. Long-range investment strategy with regard for liquidity needs includes maintaining adequate liquidity levels while at the same time minimizing the cost of those funds. If the financial institution experiences cyclical loan demand or deposit fluctuations,



educated predictions can be made for funding requirements and investments can be purchased with those needs in mind.

8. The degree of interest rate risk exposure will affect liquidity due to the cash flow changes that result from interest on rate-sensitive assets and liabilities. Liquidity plans must consider changes in cash flow due to interest rate changes.
9. In conjunction with the financial institution's investment policy, a determination must be made regarding of types of investments permitted, the desired mix among those investments, the maturity distribution and the amount of funds that will be available, and reviews of pledging requirements. A maturity ladder in the investment portfolio which is consistent with the liability structure of the financial institution should coincide with both the sources and uses of funds. Liquidity has consisted of balancing maturing liabilities with maturing assets by monitoring runoff.
10. Periodic stress testing of contingency funding plans under satisfactory, deteriorating, and unsatisfactory overall conditions to assess adequacy of plans at varying degrees of stress from both internal and external pressures.
11. Adequate Board or ALCO review of policy compliance and evaluating the current and projected liquidity position is necessary so that immediate remedial action can be taken to correct imbalances and avoid illiquid conditions. Where noted changes in the financial institution's environment affect management's predictions concerning anticipated liquidity needs, periodic review of the Policy and the financial institution's planned liquidity position can be fine-tuned to meet the liquidity needs due to the uncontrolled changes in the marketplace.
12. Approval procedures for exceptions to policies, limits, and authorization should be defined. Exceptions should be discussed by the Board or ALCO and documented in the minutes.
13. An independent review of the liquidity and funds management function should be conducted regularly.

Once anticipated and potential needs have been determined, management must decide how those needs will be met through funds management. Every financial institution should carefully consider the reasonable options to establish optimum liquidity management operations.

## **INVESTMENT POLICY**

Management of a financial institution's investment portfolio requires the adoption of a defined investment policy. The uncertainty and volatility of the bond and other investment markets of the past underscore the need for sound investment portfolio administration to achieve the desired goals of high profitability, optimum liquidity, and acceptable quality. It is the responsibility of the Board to develop the investment policy. To ensure that the directorate does not delegate policy decisions, a financial institution's investment policy must provide details and encompass minimums and maximums rather than a philosophical description of objectives. The policy should be in written form, reviewed periodically by the Board and revised as needed in view of changing circumstances and the needs of the individual financial institution. By establishing clarity of direction, a written investment policy should provide the basic foundation upon which effective portfolio strategy can be developed.

Each financial institution, regardless of size or its unique characteristics, should consider at a minimum the following major factors in formulating a written investment policy:

1. A Statement of the Objectives of the Investment Portfolio: Such objectives should include the following:
  - (a) To provide an investment medium for funds which are not needed to meet loan demand or deposit withdrawal;
  - (b) To optimize income generated from the investment account consistent with the stated objectives for liquidity and quality standards;
  - (c) To meet regulatory standards;
  - (d) To provide collateral which the financial institution is required to pledge against public monies;
  - (e) To provide an investment medium for funds which may be needed for liquidity purposes;
  - (f) To provide an investment medium which will balance market and credit risk of other assets and the financial institution's liability structure; and
  - (g) Other objectives (as deemed appropriate for the specific financial institution).
2. Assignment of Responsibilities: Responsibilities of the Board, investment officer(s), and Investment Committee should be detailed.
3. Listing of Acceptable Investments: Acceptable investments may include U.S.

Treasury securities, Federal Agency securities, municipal obligations, certificates of deposits of other financial institutions, financial institution acceptances, collateralized mortgage obligations (CMOs), etc. All investments should conform to applicable Sections of the Code of Georgia Annotated and the Rules of the Department.

4. Investment Portfolio's Composition and Investment Limitations: The policy should define responsibility for establishing minimum and maximum amounts to be invested in the various acceptable investments. Proper diversification in the investment portfolio will avoid unfavorable concentrations in obligations of a single issuer or in the types of investments whose quality depends largely upon the same set of circumstances. Appropriate geographic distribution in municipal investments should be established. Factors to be considered in establishing investment limits should include regulatory requirements and constraints, liquidity needs, tax position, and collateral and pledging requirements.
5. Acceptable Maturity Ranges: A soundly planned maturity schedule will take into consideration the financial institution's invested position, prevailing and anticipated loan demands, and the stability of mixed funding sources.
6. Acceptable Quality of Investments: Investments whose quality is reflective of speculative or substandard elements should not be purchased. Investment purchases should be restricted and purchased only after proper credit documentation has been analyzed to determine investment quality.
7. Acceptable Lot Sizes: Minimum and maximum lot sizes should be established for purchases.
8. Acceptability of Trading Securities: Trading is a day-to-day operation of buying and selling securities that requires easy access to the securities market. Trading requires experience and an expertise not available to most financial institutions. Gains and/or losses should be considered in light of the financial institution's earnings, tax, and capital positions.
9. Pledging Practices and Requirements: Investments should be adequate to secure deposits which by statute are required to be secured.
10. Accounting and Recordkeeping: Guidance on the accounting and reporting for securities should be based on generally accepted accounting principles (GAAP).
11. Credit Risk: Management should be restricted to investment quality instruments. Guidelines on credit analysis and due diligence suitability analysis should be performed to determine if instruments are suitable for purchase relative to the

financial institution's tolerance for credit risk, asset liability position, sensitivity to market risk, and liquidity exposure.

12. Pre-purchase Analysis Requirements: The institution's pre-purchase analysis should clearly document the due diligence process and quality analysis required before a security is purchased. While the analysis may contain information provided by the party selling the security, the purchase decision should be independent from the organization selling the investment product. Pre-purchase analysis should document an understanding of the product purchased, how the investment fits within the current balance sheet structure, and comparison to established policy limits and strategies.

Securities activities by financial institutions may be affected by internal factors such as a slackening of loan demand and a decline in net interest margins which may prompt some financial institutions to look more closely at the investment portfolio as a source for improving profitability. Certainly, this should always be a consideration; however, there are certain boundaries that should always be observed. Investments can have a profound impact on an institution's performance. Some of these activities are encouraged by securities dealers whose primary motivation is commission income and not the safety and soundness of the financial institution system. The following points should always be observed to help alleviate problems:

1. Written investment policies which discourage speculative trading activity should be adopted by the Board and followed by appropriate financial institution management.
2. The financial institution should adhere to specific limits on individual security issues contained in its investment policy.
3. Appropriate vendor management practices should apply to securities dealers with whom the financial institution regularly does business.
4. Comparison pricing should be considered when purchasing securities.
5. The investment officer should ascertain that the securities to be purchased are, in fact, permissible investments in conformity with the Official Code of Georgia Annotated and comply with Rules of the Department.
6. The investment officer should review a stress test before purchasing a Collateralized Mortgage Obligation, or similar investment, in order to ensure that the investment is not a "high-risk" security. Stress tests should be reviewed periodically in an assessment of the suitability and investment eligibility of the security. Stress tests are required on at least an annual basis, but during times of rapid interest rate movements, should probably be performed on a quarterly basis.

7. Management needs to be aware of the accounting treatment for the designation of "Held to Maturity," "Available for Sale," or "Trading" under accounting standards may have a significant impact on earnings and/or capital.

## **SENSITIVITY TO MARKET RISK**

All financial institutions should have a Board-approved policy to outline balance sheet goals and establish risk tolerance levels for interest rate risk exposure. In addition, all institutions should have a model to measure interest rate risk exposure. The contents of the policy and the complexity of the model should mirror the risk authorized by the Board, the actual balance sheet risk, anticipated changes from implementation of strategic changes, and challenges related to the overall condition of the institution in the economic environment.

Most Boards will choose to delegate oversight authority to the ALCO, which meets on a periodic basis no less than quarterly. The ALCO will oversee the model results to determine if daily management has appropriately controlled interest rate risk within the Board's authorized risk tolerance. Additionally, the ALCO will review the model's assumptions, inputs, and independent evaluation of the mechanics of the model as well as sufficiency of the overall process. Generally, an institution will also have a daily management committee to perform the following functions:

1. Monitor business conditions, financial markets, and regulatory changes on a continuing basis;
2. Manage the mix of rate sensitive sources and uses of funds over interest rate cycles; and
3. Evolve key loan, deposit, investment, and funds management strategies consistent with profit planning and longer-range goals and objectives.

Staff support will be important, and the management information systems used to gather information for the committee must be thorough and timely. In some cases, the data needed for the model may be housed in separate platforms. Reliance on manual preparation of information would likely be extremely burdensome and often untimely. However, some manually generated data may be needed to supplement model generated data or may be needed to prepare the data to feed into a model. The asset/liability management software package should be flexible and tailored appropriately to meet the institution's needs. As an institution grows in asset size and/or the complexity of the risk exposure changes, the model should be reassessed to determine if the model is appropriate to capture the risks relevant to the strategic direction of the institution. The important point is that information is available in the format needed and at the time needed to make sound business decisions.

The Board is responsible for ensuring that an adequate system of internal controls is both present and functioning. The Board should ensure that the model is measuring results against the risk tolerance levels that are established in the Board-approved policies. The Board should monitor the results for compliance and should require management to adhere to these limits for managing and monitoring interest rate risk. When performance exceptions arise, the minutes should document the Boards' expectations to bring performance into compliance with its policies. The

process may also include monitoring internal and external factors and events that could also have a bearing on the institution's liquidity. Some models are able to provide reports for liquidity and cash flow analysis as well. A strong correlation exists between the alignment of the model assumptions and the institution's operations and the quality of the models results.

The Board is also responsible for engaging an independent and periodic review of the interest rate risk management process and models. In addition, the review should encompass compliance with policies, procedures, and interest rate strategies. The review should occur regularly and whenever a material change is made to the process or strategic direction.

The Board should control interest rate exposure by managing the entire balance sheet, both assets and liabilities, to result in a reasonable level of interest rate risk exposure in consideration of the condition of the institution and support available from earnings and capital. Each institution has a unique set of risks, which results in varying degrees of authorized risk. The Board controls this risk through the risk limitations and activities authorized in its policies.

The Board should consider taking advantage of features of the model that are designed to assist with balance sheet planning. Most models can be configured for a static balance sheet or a dynamic balance sheet. The features that produce dynamic results are useful for both budgeting, strategic planning, and stress testing. Certain data and assumptions are input into the model to project "what if" scenarios to produce reports for executive analysis.

## **AUDIT POLICY**

Each financial institution is required to have an adequate audit program. One of the primary tools to be used by the Board of a financial institution to facilitate the implementation of an adequate audit program is the development and maintenance of a written policy on audit considerations. Such a policy would allow the Board to target and direct the audit program of the institution, thereby having a direct influence to ensure that the audit program is tailored to the needs of the institution. The policy allows the Board to consider the specific needs of the institution while giving proper consideration to the bookkeeping system being employed, the qualifications of the audit staff, the audit reporting system, and the satisfaction of legal requirements when establishing the audit program.

The management of each financial institution must decide the most effective audit technique which best fits their overall management plan. Every financial institution shall have an audit of its books and records performed in accordance with the requirements contained in the Official Code of Georgia Annotated and the Rules of the Department. It is the Board's responsibility to contract and appoint with independent audit firms. The audit policy should address the independence of the internal and external audit functions. An internal auditor shall be appointed by the Board and charged with implementation of the financial institution's internal audit program. Some management teams may choose to use a qualified in-house internal auditor, while others may choose to employ the services of an independent CPA firm to perform the duties of the internal auditor. Whichever method is utilized, legal restrictions contained in the Official Code of Georgia should be reviewed in detail to insure complete technical compliance with the provisions contained therein.

When establishing a formal audit program, the following are basic goals which the program should attain:

1. The audit program should provide assurance that the records are being posted (by whatever means employed) in an accurate, timely, safe, and sound manner;
2. The audit program should have provisions which help monitor the operating procedures being practiced;
3. The audit program should ensure that there is proper adherence to all management policies and established procedures as well as all applicable laws and regulations; and
4. The audit program should establish a robust tracking report that includes all findings and exceptions from internal audits, external audits, regulatory findings, and third party review findings. The tracking report should detail expected time frames for corrective action, personnel responsible for corrective action, and ongoing reporting requirements to the Board.



Specific elements of the internal audit function should include:

**Risk Assessment:** A risk assessment identifies the institution's business activities and their associated risks. These assessments typically analyze the risks inherent in a given business line, the mitigating control processes, and the resulting residual risk exposure of the institution. They should be updated regularly to reflect changes to the system of internal control or work processes, and to incorporate new lines of business. The risk assessment is a key component to develop the audit scope.

**Audit Plan:** An internal audit plan is based on the control risk assessment and typically includes a summary of key internal controls within each significant business activity, the timing and frequency of planned internal audit work, and a resource budget.

**Audit Program:** An internal audit program describes the objectives of the audit work and lists the procedures that will be performed during each internal audit review.

**Audit Report:** An audit report generally presents the purpose, scope, and results of the audit, including findings, conclusions, and recommendations.

**Workpapers:** Workpapers that document the work performed and support the audit report should be maintained or the financial institution should have contractual access to the documents.

**Staff Expertise and Resources:** The internal audit function should be competently supervised and staffed by people with sufficient expertise and resources to identify the risks inherent in the institution's operations and assess whether internal controls are effective.

**Outsourcing Considerations:** Even when outsourcing vendors provide internal audit services, the Board is responsible for ensuring that both the system of internal control and the internal audit function operate effectively. In any outsourced internal audit arrangement, the Board must maintain ownership of the internal audit function and provide active oversight of outsourced activities. When negotiating the outsourcing arrangement, an institution should carefully consider its current and anticipated business risks in setting each party's internal audit responsibilities. The outsourcing arrangement should not increase the risk that a breakdown of internal control will go undetected. To clearly distinguish its duties from those of the outsourcing vendor, the institution should have a written contract, often taking the form of an engagement letter.

The responsibility for the quality of an audit program ultimately rests with the Board. The Board must periodically review and make determinations concerning the qualifications of the auditor, the scope of the audit, the frequency of the various audit functions, and the techniques to be utilized. It is very important that the financial institution audit be reported directly to the Board or a committee thereof. This point should be stated in the audit policy to provide the audit independence needed to be effective and ensure the Board is fully informed.

## **CONFLICTS OF INTEREST POLICY**

The primary purpose of a written conflicts of interest policy is to manage potential risk and liability from the conduct of the affairs of the financial institution. This risk is usually manifested in the conduct of directors, officers, and employees in discharging their duties and responsibilities in the management of the affairs of the financial institution. The Board of Directors should adopt a policy to avoid even the appearance of a conflict of interest by its directors, officers, and employees when performing their fiduciary duties of care and loyalty to the financial institution. The Conflict of Interest Policy shall address the following situations or circumstances which should be avoided and/ or reported by directors, officers, employees, and/or principal stockholders to the Board:

1. Personal interest, direct or indirect, in any assets, real or personal, owned by the financial institution either purchased from or sold to the financial institution without the prior approval of the Board.
2. Report ownership interest held in the form of "business trusts" or other entities without disclosure of the identity or personal guarantees of the principals.
3. Loans or other transactions in which the officer, director, or principal stockholder (or immediate family member of each) of the financial institution receives or holds a beneficial interest.
4. Loans or other transactions in which the officer, director, or principal stockholder (or immediate family member of each) of another depository institution receives or holds a beneficial interest.
5. Loans or other transactions at any depository institution in which an officer, director, or principal stockholder (or immediate family member of each) holds a beneficial interest, either direct or indirect.
6. Loans or other transactions at any depository institution in which an officer, director, or principal stockholder (or immediate family member of each) has no direct interest but which involve parties with whom an insider has other partnership or business associations.
7. Loans extended personally by officers, directors, or principal stockholders (or immediate family member of each) to parties who are also borrowers from the financial institution or loans extended personally by any borrowing customers to an officer, director, or principal stockholder of the financial institution.
8. Written procedures for notification to the Board or any committee when asked to review a loan approval request or other transaction in which an officer, director, or

principal stockholder may be involved.

9. Prohibition for directors and officers to make or participate in voting on a loan or other transaction where there is a financial interest in the transaction.
10. At least annually directors, officers, and principal shareholders shall disclose their business interest and individuals and customers that they also do business with.
11. Directors, officers, principal stockholders, and their related interest shall conduct all transactions with the financial institution in compliance with State law and Federal law, including Regulation O of the Federal Reserve Board.
12. Directors, officers, employees, principal stockholders, and their related interest will not engage in activities in competition with the financial institution.
13. Establish procedures and practices designed to prevent conflicts of interest and self-dealing by directors, officers and employees, with respect to using confidential or other inside information in making investment decisions; using voting power as a shareholder; and authority of their position when exercising their duties in the conduct of affairs of the financial institution.

The above practices and procedures should be adopted to limit any exposure, to avoid losses and to prevent violations of civil and criminal laws from conducting the affairs of the financial institution.

## **INTERBANK LIABILITY POLICY**

The Board should adopt written policies and procedures to prevent excessive exposure to any individual correspondent financial institution in relation to the condition of the correspondent, and to monitor the financial condition of those entities. Federal Reserve Regulation F is made applicable to state nonmember financial institutions by Section 18(j) of the FDIC Act. Policy consideration should include:

- Standards for selection correspondent financial institutions;
- Periodic review of the financial condition of correspondent financial institutions;
- Reliance on another party, such as a financial institution rating agency or the financial institution's holding company, to assess the financial condition of correspondence financial institutions, provided the financial institution's Board has reviewed and approved the general assessment used by that party;
- Establish internal limits on exposure to the correspondent financial institution;
- Transactions shall be structured with the correspondent financial institution to monitor exposure to the correspondent;
- Establish appropriate procedures to address compliance with internal limits; and
- Establish procedures for periodic review and approval of policies by the Board.

## ELECTRONIC BANKING POLICY

Electronic commerce (e-commerce) is a broad term applied to activities involving the exchange of goods or services for value over a computer network or automated system. Financial institutions are becoming more aggressive in adopting electronic banking (e-banking) capabilities that include sophisticated marketing systems, remote banking capabilities, and stored-value programs. The extent of a financial institution's risk management program should be commensurate with the complexity and sophistication of the activities in which it engages.

Electronic capabilities can be segregated into three categories by degree of functionality:

- Systems that simply display information as defined by the publisher or allow for transmission of non-sensitive electronic mail (informational websites);
- Systems that allow users to share sensitive information and communicate electronic information transfer systems; and
- Systems that facilitate electronic funds transfer and other financial transactions (transactional websites for both retail and wholesale services).

Many systems will involve a combination of these capabilities. Additionally, a variety of services offer further support for e-commerce. These e-banking support services include weblinking, account aggregation, electronic authentication, website hosting, payments for e-commerce, and wireless e-banking.

Electronic financial services pose inherent risks, and cybersecurity threats continue to increase as more electronic delivery channels are developed. Management must understand those risks and adopt a comprehensive risk management program to mitigate them. The institution should develop an e-banking policy which addresses, at a minimum, the following points.

- Security Measures: The financial institution needs to have the appropriate controls, such as firewalls, virus protection, intrusion detection, and encryption. Controls should be tested periodically through vulnerability assessments and penetration testing. The institution should also be aware of and install new updates and patches in a timely manner. Additionally, institutions should be aware of a specific technology's planned obsolescence (end of life), elevated cost of vendor support for out-of-date software, and the date after which vendor support cannot be purchased even at an elevated price. Software that is no longer supported by the vendor could have widely known vulnerabilities that may provide relatively easy access for undesirable entry to the system. Moreover, management should incorporate dual control procedures wherever possible.

- Monitoring Requirements: Each institution should establish monitoring requirements for all phases of its e-commerce activities. Monitoring procedures allow the institution to determine the success and cost effectiveness of e-banking strategies. Additionally, e-banking activities should be included in the scope of the institution's audit, both internal and external.
- Incident Response Procedures: The institution's incident response plan should establish guidelines for dealing with various types of incidents within reasonable timeframes, thus minimizing the risk of loss. The policy should include identifying indicators of compromise, reporting the event internally and externally, containing the event, coordinating with law enforcement and third parties, restoring the system, and preserving data and evidence. The policy should require disclosures to affected persons and regulators as appropriate for the situation.
- Vendor Oversight: Management should perform initial due diligence prior to entering into a contract with a third-party to provide e-banking systems. As part of the initial and ongoing due diligence process, management should obtain and review vendor financial statements, along with other relevant documents, to determine vendor viability and the vendor's ability to meet service level agreements. Management must contact the primary regulator regarding outsourced services, when required by that regulator (e.g., foreign service providers).
- Contingency Planning/Disaster Recovery: The institution's contingency plan should address how to minimize the disruption of services and financial loss to the institution. The plan should include plans to communicate services outages to customers. Management should test disaster recovery procedures with the frequency of testing aligned with the business risk identified.
- E-Mail Procedures and Controls: The Board should communicate with customers the process for e-mail communications and the controls surrounding these communications.
- Account Access Procedures and Controls: Access should be controlled through industry standard, multi-factor authentication procedures that may include a combination of hurdles such as user name and passwords, pin numbers, hard or soft tokens, and biometric recognition techniques. Password administration controls should be established for items such as length, composition, incorrect log-on lockout, expiration, repeat usage, and encryption requirements.
- Website Content: The website must be reviewed for legal content and compliance disclosure requirements. Customer privacy and security policies should be properly disclosed to customers. Advertisements, notices, and disclosures must be in compliance with applicable statutes and regulations.

While many of the items listed may also apply to information technology and information security, unique risks are posed by electronic delivery channels, thus the emphasis on cybersecurity and controlling these risks. Reliance on third-party vendors for technology and uncertainties in the legal and regulatory environment also introduce unique risks to electronic delivery and payment systems. Management should minimize transaction, compliance, strategic, reputation, and liquidity risks relating to its e-banking activities. A primary focus of risk management is to minimize the negative effects of operating in an electronic environment. The policy should incorporate an ongoing process of identifying, measuring, monitoring, and managing potential risk exposure.