

# Asset Management (AM)

## Personal Fiduciary Activities

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# Introduction

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The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Personal Fiduciary Activities," is prepared for use by OCC examiners in connection with their examination and supervision of personal fiduciary products and services at national banks and federal savings associations (collectively, banks). Each bank is different and may present specific issues. Accordingly, examiners should apply the guidance in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks and federal savings associations (FSA) are referred to separately.

This booklet explains the risks associated with personal fiduciary activities and provides a framework for managing those risks. In addition to providing guidance and describing risks associated with personal fiduciary activities, this booklet provides optional examination procedures, which supplement the core assessment standards in the "Large Bank Supervision," "Community Bank Supervision," and "Federal Branches and Agencies Supervision" booklets of the *Comptroller's Handbook*. Examiners should use the optional examination procedures in this booklet when specific personal fiduciary products, services, or risks warrant review beyond the core assessment.

Personal fiduciary activities cover a broad spectrum of arrangements in which a bank is retained to provide investment management services, act as trustee, or have various degrees of responsibility for an individual's or a family's assets. What distinguishes personal fiduciary activities from other asset management arrangements is that fiduciary activities are conducted by a bank in a "fiduciary capacity" as defined by 12 CFR 9, "Fiduciary Activities of National Banks," and 12 CFR 150, "Fiduciary Powers of Federal Savings Associations." Trust law is a state, not a federal, concept. Each trust must be established and administered under state trust laws. 12 CFR 9 and 12 CFR 150 provide an additional overlay of federal law requirements that apply to national banks and FSAs, respectively.

Offering personal fiduciary products and services exposes banks to a range of risks. The nature and scope of banks' products and services determine which risks are present and what the quantity of those risks are. Given the variety of laws and regulations (state and federal) that apply to banks engaged in personal fiduciary activities, compliance risk is inherently high. Because an individual's or a family's personal wealth is typically invested in these accounts, and there is a fiduciary relationship between a bank and its customers, reputation risk is also high. Given the volume of transactions associated with many personal fiduciary accounts and relationships, operational risk can be substantial. If a bank enters into a new or modified personal fiduciary relationship, especially one based on a new state trust law, or offers a personal fiduciary account that involves outsourcing some of its responsibilities, the bank increases its strategic risk and compliance risk.

## Background

Personal fiduciary activities are part of a growing and competitive market frequently referred to as private wealth management, private client services, or private banking. These activities usually entail providing a broad range of financial products and services to affluent persons, their families, and their businesses. At the core of these products and services are fiduciary relationships, the investment management of client assets, and providing investment advice for a fee.

The federal statute that empowers the OCC to grant fiduciary powers, 12 USC 92a(a), specifically authorizes the OCC to permit national banks to act in seven fiduciary capacities—trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, and receiver. The act also authorizes any other fiduciary capacity in which state banks, trust companies, or other corporations that come into competition with national banks are permitted to act under the laws of the state in which the national bank is located.

A fiduciary relationship involves a duty on the part of the fiduciary (the bank) to act for the benefit of the other party to the relationship (the customer) concerning matters within the scope of the relationship. Fiduciary law is designed to protect the party who gives fiduciary power (grantor) to another party (fiduciary) and those who may ultimately benefit from that transfer of power (the beneficiaries) from the significant risks inherent in the fiduciary relationship. The underlying premise of fiduciary law is to afford grantors legal protections that might otherwise be unavailable, too costly, or impractical to obtain. 12 USC 1464(n) authorizes the OCC to permit FSAs to act in four capacities—trustee, executor, administrator, and guardian. The act also authorizes “any other fiduciary capacity in which State banks, trust companies, or other corporations which compete with [FSAs] are permitted to act under the laws of the State in which the [FSA] is located.”<sup>1</sup> If a state permits state banks, trust companies, or other corporations that compete with national banks or FSAs to act in capacities in addition to the enumerated ones, 12 USC 92a(a) and 12 USC 1464(n) empower the OCC to authorize national banks and FSAs to act in those capacities. Pursuant to this statutory authority, the OCC has issued regulations that describe the multi-state fiduciary authority of national banks (12 CFR 9.7) and FSAs (12 CFR 150.130). Using this authority, a national bank or FSA may conduct fiduciary activities out of one state and offer fiduciary activities, including personal fiduciary products and services, to customers located in any state.

12 CFR 9 sets forth the standards that apply to the fiduciary activities of national banks. This part applies to all national banks and federal branches of foreign banks that act in a fiduciary capacity. 12 CFR 150 sets forth the standards that apply to the fiduciary activities of FSAs. For the purposes of 12 CFR 9 and 12 CFR 150, fiduciary capacity is defined as

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<sup>1</sup> Given the expansive fiduciary language in this section of HOLA, despite the slight differences in the statutory fiduciary language for national banks and FSAs, there is no difference between the fiduciary capacities the OCC has granted national banks and FSAs.

- a trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gifts to minors act.<sup>2</sup>
- an investment adviser, if the bank receives a fee for its investment advice.
- any capacity in which the bank possesses investment discretion on behalf of another.
- any other similar capacity that the OCC authorizes pursuant to 12 USC 92a or 12 USC 1464(n).

These regulations are generally permissive and authorize specific fiduciary activities for national banks and FSAs unless the activities are restricted or prohibited by applicable law. The applicable law for a national bank is defined in 12 CFR 9.2(b) and for a FSA is defined in 12 CFR 150.60 as

- the terms of the instrument, or legal document, governing a fiduciary relationship.
- the law of a state or other jurisdiction governing a bank's fiduciary relationships.
- applicable federal law governing those relationships (for example, federal securities laws or the Employee Retirement Income Security Act of 1974).
- any court order pertaining to the relationship.

While 12 CFR 9 and 12 CFR 150 reflect common fiduciary principles and their provisions are not specific to a particular state law or a type of fiduciary instrument, certain parts are linked to other fiduciary laws. For example, the fiduciary compensation provisions in 12 CFR 9.15 and 12 CFR 150.380 authorize a bank to charge a reasonable fee for its services unless compensation terms are set or governed by other applicable law. Certain provisions of 12 CFR 9 and 12 CFR 150 are restrictive and prohibit certain fiduciary activities unless applicable law expressly authorizes those activities. For example, the conflict of interest provisions in 12 CFR 9.12 for national banks and 12 CFR 150.330 through 12 CFR 150.400 for FSAs prohibit engaging in self-dealing or entering into conflict situations unless expressly authorized by applicable law.

Compliance with fiduciary law, however, is neither a guarantee against loss nor an assurance of expected performance by the fiduciary. Courts have recognized that even sound fiduciary administration and investment practices can produce unexpected losses. Nearly every state has adopted some form of the Uniform Prudent Investor Act of 1992. The expectation under these state laws is that if a trustee's investments were consistent with the overall objectives of the account when made, and the investments were made to diversify the client's portfolio, losses on the individual investments in the diversified portfolio do not mean the trustee violated his or her fiduciary responsibilities.

## Fiduciary Accounts

Banks provide fiduciary services to a variety of personal accounts. Personal trust accounts are typically established to accomplish certain objectives for customers, such as

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<sup>2</sup> While there are slight differences in the specific language in 12 CFR 9.2(e) for national banks and 12 CFR 150.30 for FSAs, the scope of when national banks and FSAs act in a fiduciary capacity is the same.

single risk management system works for every bank. A bank should establish a risk management system suited to its own needs and circumstances.

## Board and Management Supervision

Personal fiduciary activities must be managed by or must be under the direction of a bank's board. A board may assign fiduciary management authority to any bank director, officer, employee, or committee. The board may use the qualified personnel and facilities of its affiliates to fulfill its fiduciary responsibilities (12 CFR 9.4 for national banks and 12 CFR 150.150 for FSAs). While others may be assigned certain responsibilities, the board is ultimately responsible for a bank's fiduciary activities.

12 CFR 9.4(c) authorizes national banks and 12 CFR 150.180 authorizes FSAs to purchase services related to the exercise of the bank's fiduciary powers (to the extent not prohibited by applicable law). If the board uses the services of a third-party vendor, the board should ensure that the activity is conducted in a safe and sound manner and in compliance with applicable law. The board and senior management should provide proper oversight of those given the authority to administer personal fiduciary services, including a third-party vendor. OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," provides risk management guidance for these types of service arrangements.

The bank's board and senior management are responsible for ensuring that the fiduciary risk management system includes sound internal controls and an adequate and effective audit program. If personal fiduciary activities represent a significant fiduciary activity, the activities must be included in the bank's fiduciary audit program as required by 12 CFR 9.9 for national banks and 12 CFR 150.440 for FSAs.

The "Asset Management" booklet of the *Comptroller's Handbook* contains additional information on the OCC's expectations for board and management supervision of fiduciary activities. The "Investment Management Services" booklet of the *Comptroller's Handbook* contains detailed materials that are of particular importance for bank fiduciaries that accept investment management responsibilities on behalf of their personal fiduciary clients.

## Policies and Procedures

12 CFR 9.5 for national banks and 12 CFR 150.140 for FSAs require banks to adopt and follow written policies and procedures that are adequate to maintain the banks' fiduciary activities in compliance with applicable law. The scope and detail of fiduciary policies and procedures depend on the complexity of the products and services provided. In general, the more complex the fiduciary services offered, the greater the need for formalized and detailed policies and procedures.

12 CFR 9.5 for national banks and 12 CFR 150.140 for FSAs also require banks' fiduciary policies to address, where appropriate, the following:

- Broker placement practices
- Use of inside information relating to security transactions
- Self-dealing and conflicts of interest
- Selection and retention of legal counsel
- Investment of fiduciary funds

12 CFR 9.8 requires national banks and 12 CFR 150.410 through 12 CFR 150.430 require FSAs to adequately document the establishment and termination of each fiduciary account. Banks are also required to maintain adequate records for all fiduciary accounts. These records must be maintained for a period of at least three years from the later of the termination of the account or the termination of any litigation relating to that account. Fiduciary records must be maintained separate and distinct from other bank records. In addition to these core fiduciary record-keeping requirements, depending on the nature of the transactions in personal fiduciary accounts, banks may be required to document certain securities transactions and to provide trade confirmations (required by 12 CFR 12 for national banks and 12 CFR 151 for FSAs). There are also likely to be federal and state tax records and filings associated with personal fiduciary accounts, as well as state escheat<sup>6</sup> records for personal fiduciary assets for which the bank can no longer locate the lawful beneficiaries.

The following topics are examples of policies and procedures a bank might adopt based on the specific personal fiduciary products and services offered:

- Account acceptance
- Account administration
- Management information reporting

A bank's policies and procedures should specify the capacity and duty of committees or individuals authorized to sign agreements on the bank's behalf with clients and other third parties. The potential for litigation, such as by customers alleging a bank did not adequately perform its fiduciary responsibilities, should incent bank fiduciaries to describe and document their fiduciary activities and responsibilities and to monitor compliance carefully.

## Account Acceptance

### Pre-Acceptance Reviews

12 CFR 9.6(a) requires national banks and 12 CFR 150.200 requires FSAs to review prospective fiduciary accounts before accepting them. This review must document whether a bank can effectively administer the account. The bank must determine whether it has the expertise and systems to properly manage the account and whether the account meets the bank's risk and profitability standards. The pre-acceptance review is required for all accounts in which the bank acts in a fiduciary capacity regardless of how limited the bank's fiduciary

<sup>6</sup> State escheat laws provide that unclaimed assets, or assets for which a bank cannot locate a beneficial owner, are to be turned over to the state after a specified number of years (typically three to five).

role may be. A bank that accepts appointment as a directed trustee in which, for example, all investment responsibility is managed by a third party is still obligated to undertake a pre-acceptance review of the account to confirm that the bank has the staff and resources to administer the account. When a bank is only acting as trustee without investment management responsibilities or discretion for an account, and the account is poorly managed, the bank may still face reputation risk based on its duties to properly administer the account.

Early identification of risk helps the bank control the amount of risk it accepts and enables the bank to price that risk properly. Bank policies and procedures should provide guidance on the types of fiduciary accounts that are desirable and should define specific conditions for accepting new accounts. A bank should adopt and implement procedures to ensure compliance with its account acceptance policies. These include procedures designed to identify potential Bank Secrecy Act of 1970 (BSA) and anti-money laundering (AML) issues. The Federal Financial Institutions Examination Council's *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual* provides a comprehensive overview of the BSA and AML areas, and a bank's pre-acceptance review process should include consideration of these risks. The bank should establish a due diligence process for reviewing each prospective account. The due diligence process should consider applicable risk management issues and ensure compliance with the bank's policies and procedures. The results of an account's due diligence review should be documented and recorded in the appropriate bank file.

Consistent with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs, the assets used to fund a personal fiduciary account must be reviewed by the bank as part of the pre-acceptance review process to determine whether it can properly administer the account. The bank must not accept an account that holds assets beyond the skill and expertise of the bank's staff to properly administer. The bank must acquire the appropriate expertise before accepting the account or it should decline the appointment. The bank should carefully review assets that are more likely to be illiquid, such as real estate, family businesses, oil and gas properties, foreign assets, and art. Refer to the "Unique and Hard-to-Value Assets" booklet of the *Comptroller's Handbook* for additional information regarding pre-acceptance reviews of accounts holding illiquid or difficult-to-value assets.

## Conflicts of Interest

Before accepting a fiduciary account, the bank should review the governing instrument for potential conflicts of interest. A conflict of interest normally arises when the bank's ability to act exclusively in the best interest of the client is impaired. For example, the terms of a trust instrument may authorize a bank to retain stock of the bank's holding company, or of an affiliate of the bank. In situations where the bank trustee is granted investment discretion over the trust's assets, a conflict of interest is created under 12 CFR 9.12 for national banks and 12 CFR 150.330 through 12 CFR 350 for FSAs when the bank acts as a discretionary fiduciary tasked with making decisions regarding, for example, retention of own bank or affiliate's stock. While that conflict may be authorized, the conflict nonetheless should be addressed as part of the pre-acceptance, post-acceptance, and annual account reviews. If such a conflict exists, the bank should take appropriate action to resolve the conflict before

accepting the account. Refer to the “Conflicts of Interest” booklet of the *Comptroller’s Handbook* for additional information.

## Successor Trusteeships

Under common law, a trust will not fail for lack of a trustee. Generally, four conditions may result in a trustee vacancy:

- Disclaimer (that is, refusal to act) by a person or corporation appointed to act as a trustee.
- Dissolution of a corporate trustee or the death of an individual trustee.
- Resignation of a trustee in accordance with the terms and conditions of the trust instrument.
- Removal of a trustee in accordance with the terms and conditions of the trust instrument or by a court with appropriate jurisdiction.

If a trustee vacancy occurs, a successor trustee is appointed in accordance with (1) the terms and conditions of the trust instrument, (2) procedures set forth in applicable state statutes, or (3) a court having jurisdiction over the trust. Generally, a successor trustee may exercise all of the powers granted to the original trustee, unless the trust instrument provides to the contrary.

A bank may be asked or appointed by a court to act as a successor trustee. A bank serving in this capacity may be subject to potential liability stemming from the acts of the prior trustee. Under common law, a successor trustee may be liable for mismanagement if it retains an improper investment made by the predecessor trustee, does not attempt to marshal the fiduciary property (that is, to inventory and appraise it), or fails to compel the predecessor trustee to redress a breach of trust.

The successor trustee’s duty is to enforce any claim that the account may have against the prior trustee.

Before accepting a successor trusteeship, a bank should perform a due diligence review of all previous account activity, identify and review all account assets, and, if possible, obtain indemnification from the prior trustee for any actions taken before assumption of the fiduciary relationship. Some states have passed statutes that protect a successor trustee from the acts of a predecessor. A bank should have a written record, however, indicating that a proper due diligence investigation has been performed or have appropriate releases from the court or all beneficiaries. A court order, or releases from all life tenants, remainder interests, and contingent beneficiaries, may provide some protection from the assumption of successor trustee liability.

## Exculpatory Clauses

A will or trust instrument may include an exculpatory clause that attempts to relieve the trustee from certain liabilities. The trustee is not, however, always protected by such a provision, and the provision typically does not protect a trustee from a breach of trust or from

actions that are illegal. Before accepting a fiduciary account, the bank should obtain legal advice concerning the effectiveness of such clauses in trust documents.

## **Cotrustees**

A trust instrument may provide for the bank to administer the trust with a cotrustee. The cotrustee may be one or more persons or another bank or trust company. Cotrustees are added to provide special expertise or to ensure that certain family interests are considered when decisions are made regarding the account. Trust instruments generally require cotrustees to act in unison.

When a bank acts as a cotrustee with another bank, each bank must perform its duties as though it were the sole fiduciary. A cotrustee agreement between two banks must set forth the terms and conditions under which they will jointly carry out their duties and obligations. Because of the potential liability associated with acting as a cotrustee, the trust instrument should be reviewed by each bank's legal counsel and be approved by its board of directors or designated committee.

## **Establishment of Accounts and Post-Acceptance Account Reviews**

A written legal document, such as a trust agreement or agency contract, formally establishes the fiduciary relationship. The governing document should clearly specify the bank's fiduciary duties and obligations and articulate the nature and limits of each party's status as agent or principal. A bank trustee should analyze provisions in the instrument about co-fiduciaries (cotrustees)—who can be individuals, banks, or other financial institutions—to determine whether the bank has any unusual or special responsibilities.

Account administrators often use checklists to ensure that they obtain all information needed to establish an account. These checklists usually itemize all the documents required to open an account (for example, governing document, asset schedules, fee schedules, and court documents). Adoption and reliance on a tickler system is necessary to ensure that legal filings, tax payments, account reviews, income remittances, and principal distributions occur on a timely basis; insurance and tax deadlines are met; and termination events occur.

Once the account has been formally established, the account is funded by the transfer of assets into the trust account. Funding involves current assets of the trust and assets that are subsequently purchased for the account or added by the grantor. The account administrator may provide the operations department an inventory of assets to be deposited into the account so that appropriate accounting entries can be made. All assets must be accurately described in the inventory.

Upon acceptance of a fiduciary account for which the bank has investment discretion, the bank must promptly review all assets of the account, in accordance with 12 CFR 9.6(b) for national banks and 12 CFR 150.210 for FSAs, to evaluate whether the assets are appropriate for the account. The appropriateness of each asset depends on the purpose of the account and

the needs and circumstances of account beneficiaries. An investment policy statement should be created that establishes the account's investment objectives and strategies.

A bank's initial assessment of investment management risk and reward is fundamental to sound portfolio management for a particular account. The process of reviewing a client's objectives, characteristics, and investment portfolio before acceptance of a fiduciary investment management mandate should be thorough to ensure the management of the account is consistent with its underlying purpose and objectives. The bank's approval authority should be structured to ensure that the types of personal fiduciary accounts accepted are consistent with the bank's overall risk strategies and are authorized by policy. Risk managers should ensure that the bank has the requisite resources and expertise (or can obtain the expertise at reasonable cost) to appropriately manage the portfolio. Refer to the "Investment Management Services" booklet of the *Comptroller's Handbook* for additional information on account investment management and investment policy statements.

Reviewing a synoptic record is common during the initial post-acceptance review. Synoptic information includes a summary of the governing instrument that states the bank's powers, any special circumstances (including assets that must be retained and authorizations required to invest in proprietary mutual funds), and information on beneficiaries. The synoptic information should also include a brief summary of the account's investment policy statement.

## Account Administration

The fiduciary's fundamental duty is to administer an account solely in the client's interest. The duty of loyalty is of paramount importance and underlies the entire administration of personal fiduciary accounts. Successful account administration meets the needs of clients in a safe and productive manner while equitably balancing the interests of each beneficiary.

The governing instrument, such as a will, trust agreement, court order, or agency contract, controls the administration of a fiduciary account. State statutes and provisions of 12 CFR 9 for national banks and 12 CFR 150 for FSAs take precedence when the governing instrument is silent or when state law or federal regulations include provisions that cannot be waived or altered (for example, state spousal share or community property statutes). A body of common law (court rulings) has developed over time to help determine a fiduciary's responsibilities when neither statute nor the governing instrument specifically addresses a particular issue.

## Investment Management

Effective risk management requires that a bank identify and understand the investment risks specific to a particular personal fiduciary account or portfolio within that account. Risk assessment processes help determine what the risks are, how they should be measured, and what controls and monitoring systems are needed. Those responsible for managing risk in the personal fiduciary area should be familiar with the types of risk embedded in those accounts and be able to estimate the levels of risk created by the investments in those accounts. Business line, portfolio, and other risk managers should understand the characteristics and

- **Charitable remainder annuity trust.** This arrangement pays the annuity beneficiary a fixed annual amount during his or her lifetime. That annual amount must be at least 5 percent of the value of the property when the trust was established. The remainder interest goes to the qualified charity at the annuitant's death.
- **Charitable remainder unitrust.** This arrangement provides that the lifetime income beneficiary will receive a fixed percentage (at least 5 percent) of the fair market value of the trust calculated annually. The remainder interest must be given to a qualified charity.

## Charitable Lead Trust

A CLT is the reverse of a CRT because it allows a grantor to provide the interest income from the trust to a qualified charity for a defined period of time with the remaining assets reverting back to the grantor or to named beneficiaries at the end of the trust's term. A CLT can be either inter vivos or testamentary.

This type of trust is attractive for a donor who regularly makes gifts to charity. Using this type of arrangement, the donor can continue to make charitable contributions during his or her lifetime while retaining the remainder interest in the property for the benefit of his or her heirs. The value of the taxable gift can be substantially reduced, thereby eliminating the taxes paid during the donor's lifetime. Like the remainder trust, the lead trust can be an annuity trust or a unitrust.

## Donor-Advised Fund

While outside of the fiduciary structure of a bank, a donor-advised fund can provide an efficient and inexpensive vehicle for making tax-advantaged charitable contributions. These funds are operated by an IRS-authorized sponsoring organization and may be run by a bank or other financial institution, or by an eligible community, educational, or religious organization. Subject to certain tax and timing limits established by the Internal Revenue Code, these funds enable a donor to donate appreciated property (such as individual securities or mutual fund shares) to the sponsoring organization without recognizing capital gains. The sponsoring organization typically sells the donated property and deposits the proceeds into an account over which the donor retains advisory privileges. The donor, or the donor's representative, then advises the sponsoring organization which IRS-authorized not-for-profit organizations are to receive some or all of the proceeds obtained from the donor's charitable contribution.

## Pre-Need Funeral and Cemetery Trusts

This type of trust is marketed by the funeral industry and is designed to pay the purchaser's funeral and/or cemetery expenses, such as the casket, gravestone, funeral plot, and perpetual care. The laws and regulations governing these trusts vary from state to state. Although many states require that banks serve as trustees of these trusts, some allow funeral directors or other parties to serve as trustee. Depending on the state law and contract terms, a pre-need funeral trust may be revocable or irrevocable. Usually, the purchaser has the choice. An irrevocable

trust may be necessary to enable purchasers to maintain their eligibility for state or federal income assistance (for example, Medicaid coverage of nursing home expenses).

Banks serve as trustee, custodian, and investment manager for pre-need funeral trusts. While the risks from serving in these capacities for a pre-need arrangement, theoretically, are not significantly different from risks created by other fiduciary relationships, a bank offering pre-need trusts may be required to

- comply with applicable state and federal law, including reporting requirements.
- safekeep all funds received, including income.
- manage, administer, and invest the assets as permitted by applicable law.
- exercise all voting and other rights relating to the trust funds.
- make payments from the trust according to the trust agreement and applicable law.
- maintain financial statements and other records with respect to the trust.
- issue annual 1099 forms to the trust beneficiaries.

Banks frequently combine pre-need trust assets into a pooled investment fund, either a common fund (an A1 collective investment fund) established under state law and 12 CFR 9.18(a)(1), or a fund established under 12 CFR 9.18(c)(4) that is authorized by a state's pre-need funeral or cemetery trust laws. As detailed in the "Collective Investment Funds" booklet of the *Comptroller's Handbook*, these pooled funds must be operated not only in a manner consistent with OCC regulations and applicable state law, but also with the applicable statutory exemption under the Investment Company Act of 1940.

Pre-need funeral trusts present unique risks for a bank trustee to consider and manage. A fundamental difference exists between a pre-need funeral trust and other trust relationships. Many banks serving as trustee in a pre-need trust have only limited interaction with the purchaser of the funeral contract and the provider of the trust funds. The bank's contact and business relationship is primarily with the funeral company. The consumer's primary contract is also typically with the funeral company or funeral director, not with the bank trustee. Upon the death of the consumer, the bank remits the proceeds of the trust to the funeral company in accordance with the terms of the trust and contract, not to the individual's family or heirs as is common in most trust relationships.

What makes this arrangement particularly sensitive is that pre-need funeral trusts are usually accounts established by funeral homes on behalf of individuals who are elderly or have limited financial resources. Absent appropriate policies, procedures, controls, and monitoring systems, this business line can create increased operational, compliance, and reputation risks.

Poor management of pre-need funeral trusts, including weak internal controls over account acceptance and disbursements, noncompliance with trust agreements and applicable law, and inadequate due diligence reviews of funeral homes and directors, can negatively affect a bank's reputation. Banks that align themselves or are affiliated with funeral companies that have or subsequently develop reputation problems may themselves be tarnished, even if their internal practices are sound.

Banks active in this line of business must have appropriate strategic plans, policies and procedures, internal controls, MIS, and monitoring systems for this product. Pre-acceptance, post-acceptance, and annual review processes are particularly important. It may be appropriate to have policies and procedures specific to this business line, and if the business is significant for a bank, a separate administrative and investment review committee should be established.

Banks must perform a due diligence review on a funeral company before entering into a business arrangement with it. Refer to OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance.” A bank should also include pre-need funeral trusts in internal compliance and audit programs.

Limited purpose trust banks that concentrate their business in pre-need funeral arrangements and banks that aggressively solicit this business may pose heightened risk. Examiners should review a bank’s risk management practices relating to this line of business to ensure that the bank is in a position to effectively assess and manage the risks associated with providing pre-need funeral or cemetery trust services.