

Asset Management (AM)

Personal Fiduciary Activities

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Introduction

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.”¹ 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

¹ 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.²
- 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

² 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.

- estate planning.
- reducing taxes.
- maintaining privacy.
- passing assets to dependents, relatives, and other beneficiaries.
- contributing to charitable organizations.
- ensuring assets continue to be managed in the event of illness or incapacitation.

Depending on how the accounts are structured, banks' fiduciary roles may vary widely. Ultimately, customers, usually with the assistance of their personal counsel, establish the legal framework that the bank trustees must follow.

In the past, personal trust accounts and other fiduciary relationships were offered primarily to the very wealthy. Now these services are offered to a broader range of clients, as more bank clients seek to structure their financial assets in tax-efficient ways that not only protect those assets but ensure they are passed down to the persons and entities the clients designate. A bank's role as fiduciary to these accounts is likely to vary widely. Some personal trust relationships provide that the bank fiduciary assume not only account administration and accounting responsibilities but also investment management and legal obligations for the proper administration of the trust. Other fiduciary arrangements, such as certain investment management and investment advisory relationships, relieve the bank of some fiduciary responsibilities but retain core fiduciary requirements, such as pre-acceptance reviews, limitations on conflicts of interest, and custody requirements. As discussed in detail in the "Risks Associated With Personal Fiduciary Activities" and "Risk Management" sections of this booklet, each of the roles and capacities a bank assumes presents a different degree of risk. These risks must be understood, and policies, procedures, and processes must be adopted and implemented to mitigate the level of risk the bank fiduciary assumes.

Personal fiduciary accounts may be divided into three major groups:

- Court-supervised accounts
- Trust agreements
- Investment accounts

Court-Supervised Accounts

Estates, guardianships, conservatorships, and certain trusts are administered under the jurisdiction of the appropriate court of law based on applicable state trust law. The court's principal role is to protect the interests of the deceased, minors, and incompetents. The court formally appoints the fiduciary in accordance with state law requirements and reviews and approves all subsequent acts of the fiduciary related to that particular account. In some states, a testamentary trust, a trust established by a will that becomes effective upon the death of a testator (the person who has written the will), may also be administered under the order and protection of a court. Appendix A, "Types of Personal Trusts," includes descriptions of the more significant personal trust relationships.

Estates

Planning: An estate is the property left by a person when he or she dies. That person is usually referred to as the decedent or, if a will exists, the testator. Estate planning addresses the use, conservation, and disposition of an estate. This is the process by which a person, while still living, plans for the transfer and disposition of his or her property after he or she dies.

A comprehensive estate plan allows a person to

- dispose of assets according to personal wishes.
- establish effective tax strategies.
- provide for oneself and family in the event of incapacity.
- obtain professional asset management services.
- select personal representatives.
- name guardians for minor children.
- maintain the privacy of personal information.
- provide protection for the beneficiaries of the estate.

The development and implementation of an effective estate plan requires different types of legal and financial expertise as well as good communication among members of the estate planning team. Common documents in estate planning include wills, trust agreements, powers of attorney, advanced medical directives or living wills, Health Insurance Portability and Accountability Act of 1996 releases, letters of instruction, and beneficiary designations established through insurance policies, individual retirement accounts (IRA), and retirement plans.

An important part of creating an estate plan is selecting suitable individuals or corporations to serve in the various fiduciary capacities. These capacities include the executor or personal representative, trustee, guardian for minor children, and an agent or attorney-in-fact to serve under a durable power of attorney. A power of attorney is an instrument authorizing a person to act as an agent or attorney-in-fact for another person. The person given power of attorney makes financial and legal decisions on behalf of the person granting the power. A durable power of attorney remains effective even if the grantor becomes incapacitated.

State trust laws typically permit only a bank or a trust company to serve as a corporate trustee. All other trustees are individual trustees—not corporations. Unlike banks and trust companies, registered advisers, broker-dealers, and insurance companies are not typically authorized by states to act as trustees. A corporate fiduciary, however, is generally not allowed to serve as a guardian of a person or as an agent under a power of attorney for health care. A corporate fiduciary may serve as a guardian of an estate and, in some circumstances, as an agent under a power of attorney for financial or property purposes.

A bank fiduciary's role in the estate planning process is one of facilitator, and extreme care should be taken in working with clients and advisers. The role of the client's attorney is to create the estate plan and draft the legal documents. Although a bank fiduciary may discuss

legal concepts and estate planning alternatives with clients and prospects, only an attorney familiar with the applicable state trust laws should actually draw up the estate plan.

Administration and settlement: Probate is one of the ways to pass ownership of estate property to a decedent's survivors or heirs. Probate is the legal process by which a court validates a decedent's will and supervises the administration of the estate. The probate estate is the portion of the estate that must go through the probate process before the estate is transferred. Certain estate interests, such as living trusts, life insurance policy proceeds not payable to the estate, payable upon death accounts (Totten trusts), property held jointly with rights of survivorship, and accounts—such as an IRA or a 401(k)—for which there is a beneficiary designation are generally not included in the probate estate. Many states also provide the opportunity for the decedent's spouse or other heirs (such as children or siblings) to obtain property held in the decedent's name (such as a bank deposit) by submitting a small-estate affidavit to the holder of the decedent's property. This enables the assets of relatively small estates (usually less than \$25,000) to be distributed directly to the spouse or other heirs without going through the time and expense of probate.

Probating an estate requires the appointment of a personal representative to administer the estate. The representative may be called the executor, administrator, or personal representative of the estate if appointed as such in a decedent's will. If someone dies without a valid will (intestate) or a will does not name a personal representative, the court appoints someone to administer the estate (the administrator). The court issues letters testamentary or letters of administration granting the personal representative authority to administer the estate.

The appropriate court determines the validity of a decedent's will. Once the court validates the will, the court appoints the personal representative. Upon formal acceptance of the appointment, the personal representative administers the estate in accordance with the terms of the will and other appropriate orders. In a limited number of situations, state law overrides the terms of valid wills. For example, a decedent who attempted to leave a spouse out of a will may be prevented from so doing by specific state laws (e.g., spousal share or elective share) that, in common-law states, provide the surviving spouse with a right to a certain percentage of the estate of the deceased spouse. Similarly, in the nine states that recognize community property between spouses, at the death of one spouse, half of the marital assets are considered to belong to the surviving spouse.

In most states, a will is valid only when written, signed, and witnessed in accordance with specific statutory requirements. Generally, the testator must be competent, of legal age, and not under duress. A will may be deemed invalid by a court if the will fails to meet specific statutory guidelines. If there is no valid will, state law governs who inherits and how much under the state's law of intestate succession.

A personal representative, until receiving authority from the probate court, has no power to dispose of any part of an estate, except to pay reasonable funeral expenses or to take such action as the representative deems necessary to preserve estate property. Pending formal

authorization by the court, the personal representative may take appropriate action to handle family issues and protect estate property. Such actions might include the following:

- Locate, read, and interpret the will and any codicils to the will.
- Meet with family members and counsel to discuss immediate concerns and problems.
- Make funeral, burial, and perpetual care arrangements as directed, or as circumstances require.
- Take immediate steps for the temporary protection of estate property pending probate of the will.
- Locate financial records and determine the nature and location of estate property.
- Determine whether there are outstanding lawsuits initiated by or against the decedent.
- Change locks to secure real property.
- Change address to forward mail to the representative.
- Check property insurance coverage and adjust as prudent.
- Notify financial institutions and certain creditors of the death, and close any revolving credit accounts.
- Notify the following of the death: the U.S. Social Security Administration, pension plans, insurance companies, and others making regular pension or annuity payments.

After the personal representative receives court authorization, the personal representative may begin formal settlement of the estate. The personal representative's duties are governed by the provisions of the decedent's validated estate documents, state probate codes, court orders, and sound fiduciary principles. Important administrative responsibilities include the following:

- Identify, possess, safeguard, appraise, and invest estate assets. This includes determining whether the estate has outstanding claims against third parties. Insurance coverage should be reviewed and adjusted as needed.
- Prepare and file an inventory with the court, as required by state law or the court.
- Notify heirs and beneficiaries. Most states require that formal notices be sent to identified heirs and beneficiaries of decedents.
- Notify interested parties and creditors. This notice formally advises parties with claims against the estate to present the claims by the date specified in the notice. The representative also contests any improper claims against the estate.
- Prepare federal, state, and local income tax returns; prepare applicable federal and state estate and/or inheritance tax returns; and pay tax liabilities. The representative has the power to sell estate assets to pay the liabilities and expenses of the estate.
- Pay legacies (gifts of personal property), devises (gifts of real property), and bequests; obtain proper receipts and releases, including an estate tax release from the Internal Revenue Service (IRS), if appropriate.
- Fund trusts established under the will and distribute remaining assets to beneficiaries, including distribution to any preexisting trusts.
- Submit a final accounting to the probate court and close probate administration. In some states, the court may require ongoing accountings.

When the representative files an accounting in court, the accounting is settled judicially and in the formal manner prescribed by law. The accounting is a report of the representative's administration of the estate and provides all concerned parties, including beneficiaries and any unpaid creditors, the opportunity to comment on what has or has not been done. The court then customarily approves the final accounting and discharges the representative, unless objections are filed and sustained.

Guardianships and Conservatorships

A guardianship (for purposes of this booklet, the term guardian includes conservators) is a court-appointed fiduciary relationship established to protect a person who is not of legal age or who is mentally or physically incapacitated. This person is commonly referred to as a ward. While state laws vary, in general, a guardian is an individual or trust institution appointed by a court to care for and manage the personal affairs of a ward. A conservator is generally appointed by a court to manage a ward's property or financial affairs.

In most states, there are two kinds of guardians: a guardian of the property or estate and a guardian of the person. Generally, a bank is appointed guardian of the property or estate (conservator) that maintains the ward. A relative or friend of the ward is typically appointed guardian of the person. Once the court has determined that a guardian is necessary, the court enters an order and issues a letter of guardianship. This document is the guardian's authority to act on behalf of the ward.

The fiduciary's role as a guardian is analogous to the role of a court-appointed personal representative or trustee, but the guardian's role is more restrictive. The guardian's objectives are to meet the needs of the ward and to prudently manage the account's assets. A guardian's basic duties are to

- gather the ward's assets. Ownership of the property is legally transferred to the name of the guardian with the ward retaining a beneficial interest in the property.
- manage the property in the ward's best interests. The guardian is responsible for the property's protection and investment. The guardian's objective should be to make the property productive and to satisfy the ward's day-to-day requirements. Some states restrict the types of investments guardians may make.
- make periodic accountings to the court. Under most state statutes, accountings are required annually.
- terminate and distribute the property. Generally, either of two events terminates the guardianship: the ward's death or resolution of the ward's incapacity. If the ward dies, the guardianship immediately terminates and the ward's assets are distributed by the guardian to the personal representative or executor of the ward's estate. If the guardianship is based on the ward's lack of legal age, the guardianship terminates when the ward reaches the age of majority. If the guardianship is based on another kind of incapacity, it terminates when the court declares the ward competent.

Trust Agreements

Personal trust services are a significant part of most banks' fiduciary business. A trust is a flexible legal instrument whereby one person is enabled to deal with property for the benefit of another person. A trust can be used for many purposes, including

- estate planning.
- professional asset management.
- disability planning.
- privacy.
- probate avoidance.
- providing financial support for the grantor and others.
- other special needs and goals.

Characteristics of a Trust

A trust is a fiduciary relationship in which a person or entity holds the legal title to property but is obligated to keep or use the property for the benefit of another person or entity. The creator of a trust is known as the grantor, settlor, testator, donor, or maker. To be valid, a trust must demonstrate or meet the following standards:

- Intent to create a trust by a legally competent grantor
- Present act of declaration or transfer by the grantor
- Existence of trust property
- Designation of a trustee
- Identification of beneficiaries
- Delivery of trust property to the trustee

The grantor can create a trust during his or her lifetime under an agreement or declaration (living trust) or through the execution of a valid will (testamentary trust). The grantor transfers legal title of the property to the trustee as a fiduciary, while the equitable or beneficial interest in the property (income and principal) is assigned to persons designated by name or class as the beneficiaries.

A trust agreement (or trust instrument) is the formal written document that sets forth the terms of the trust. The trust agreement is generally prepared or reviewed by an attorney. A trust agreement can be established by a will, by an instrument other than a will, or by court order. The trust agreement normally

- defines the grantor's intent.
- appoints a trustee.
- identifies the beneficiaries.
- defines what the beneficiaries are to receive.
- defines the trustee's powers, duties, and compensation.

Trust Property and Accounting

The property of a trust is referred to as the trust corpus. The corpus includes both principal and income assets as well as cash (also allocated between principal and income) owned by the trust. An underlying principle of trust accounting is to maintain accounting records that properly segregate income from principal. The underlying purpose of this separation is to ensure that the two classes of persons with an interest in a trust are treated fairly and in the manner prescribed by the trust instrument.

Principal consists of both the initial and any subsequent funding from the grantor, as well as any gains or losses from the sale of trust assets. Income generally includes receipts (interest, income, rent) earned by trust assets, reduced by specific expenses associated with trust assets.

Personal trusts typically have income beneficiaries who are the present-day beneficiaries of the income from the trust, often the spouse or children of the grantor. Depending on the instrument, principal may or may not be available for distribution to the income beneficiaries. The ultimate beneficiary of the principal when the trust terminates, or upon the occurrence of a life event defined in the agreement, is commonly referred to as the remainderman. In addition, many trusts have future or contingent beneficiaries who, depending on many factors, may ultimately receive distributions from the trust corpus as either income or principal beneficiaries.

The receipt of or disbursement from income and principal affects the value of the trust corpus and its eventual distribution to remaindermen as directed by the terms of the trust agreement. Cash received from transactions is categorized as income or principal depending on its source.

The proper allocation of cash and assets to either income or principal, and the ultimate distribution of property to income or principal beneficiaries, is determined by the provisions of the trust agreement. The trust agreement may contain specific guidance for the application of principal and income transactions, may explicitly reference relevant state trust law, or by its silence, may defer to applicable state law. A bank should refer first to the governing instrument, then to applicable state law to ensure the bank's trust accounting records and distributions to trust beneficiaries are consistent with applicable law.

To define the respective interests of different trust beneficiaries when the governing instrument is either silent or provides inadequate guidance, most states have adopted a version of the Uniform Principal and Income Act of 1997 (as amended in 2000) (UPIA). Because principal and income statutes differ from state to state,³ trust administrators not only must have expertise in interpreting their own state's statutory principal and income requirements, but also must have expertise available to them regarding the principal and income requirements of each state's laws that apply to a trust managed by the bank. A trust administrator must also have sufficient expertise to interpret specific provisions of a

³ In some states, earlier versions of the UPIA remain in effect. States that adopt a uniform act generally incorporate modifications to the uniform version.

governing instrument with respect to the allocation of receipts and expenses between principal and income, and the distribution of the corpus to the respective beneficiaries.

While the allocation of some receipts to income or principal is readily apparent, allocating other receipts requires specific knowledge of applicable law. Banks should have well-documented processes to review receipts and disbursements and to allocate entries between principal and income. These processes should include well-documented procedures and appropriate training in the operations area to ensure the terms of the governing instrument or applicable state principal and income law is followed.

Examples of transactions or asset classes that require special attention include

- capital gains distributions from mutual funds.
- assets subject to amortization and accretion of premiums and discounts.
- receipts from assets such as mortgage pools that include both a return of principal and an income payment.
- depleting assets such as mineral interests.
- trustee and related fees.

The broader the range of investment options managed by a bank's trust department, the more issues may arise regarding allocation of principal and income in that account. The "Unique and Hard-to-Value Assets" booklet of the *Comptroller's Handbook* focuses on this issue in the context of mineral interests and timber holdings.

Many trusts include specific authorization to invade trust principal in order to provide certain benefits to, or to maintain the lifestyle of, specified beneficiaries. Particularly in a low-interest-rate environment, when the actual income of a trust may be far less than originally anticipated, the trustee may be required to spend down principal to fulfill the trust's requirements.

State principal and income statutes and trust documents increasingly recognize the difficulty in providing income to current beneficiaries while preserving principal for remaindermen. As part of the evolving concepts of prudent investing and maximizing total return for a trust, many states provide trustees with discretionary authority to invest the assets of a trust to benefit the remaindermen (seeking long-term appreciation of trust principal) while paying current income beneficiaries a set percentage of the trust. This authority can result in the trustee paying out not only current income but also a portion of the trust corpus to income beneficiaries. A trust payout in the 3 percent to 5 percent range to current beneficiaries is frequently referenced as an economically sustaining, long-term arrangement in which current income beneficiaries realize benefits from the trust without imperiling future payouts to the remaindermen.

The "Asset Management Operations and Controls" booklet of the *Comptroller's Handbook* emphasizes the importance of assigning proper codes to accounts, assets, and transactions to ensure that when posted to a bank's trust accounting system, entries are properly allocated to either principal or income.

Trust Beneficiaries

Beneficiaries receive the equitable benefits of a trust. Beneficiaries entitled to income from the trust are called income or present-interest beneficiaries, whereas beneficiaries entitled to receive the trust principal (corpus) are remaindermen.

Income beneficiaries can be either mandatory (income must be paid out to them regularly under the terms of the trust) or discretionary (the trustee decides whether to pay out some or all of the trust income in any period). Sometimes income or principal is to be paid to some or all of a group of beneficiaries, in amounts and at times determined at the trustee's discretion. This is called the power to "spray" or "sprinkle." Income not paid out is added to trust principal and reinvested.

Generally, the discretionary power to spray or sprinkle is left to the trustee, but this power can be governed by language in the trust. For example, the language in a trust might give the trustee discretion to pay out trust income "in such amounts and at such times, or not at all, and for any reason, to the exclusion of one or more persons if there is more than one in the class, as my trustees shall determine in their absolute discretion."

An example of a "class" of beneficiaries is the grantor's children. Another arrangement is to include language in the trust instrument that provides discretionary power to the trustee to make distributions subject to an objective standard, such as "as my trustees shall determine necessary and appropriate for the support and maintenance of the income beneficiary."

Some income beneficiaries receive the power to withdraw trust principal from time to time or on specified events. This power, however, can have adverse income and transfer tax results to the beneficiary and should be carefully considered by trust planners.

Two types of principal beneficiaries may be established under a trust: remaindermen and principal invasion beneficiaries. Remaindermen are the persons (or person) who receive the trust principal remaining when the trust terminates. A trust with a provision that authorizes principal invasion on behalf of one or more beneficiaries, who are usually income beneficiaries, authorizes the trustee at his or her discretion to pay out some or all of the trust principal during the trust's term.

Like the discretionary power to spray or sprinkle income, the power to invade principal may be without qualification or may be subject to some standard. An unqualified power permits the trustee to give a beneficiary any part or the entire principal at any time, as the trustee determines to be in the beneficiary's best interest, with or without consideration of the beneficiary's personal resources. Alternatively, the trust instrument may permit the trustee to invade principal only in accordance with a specific, ascertainable standard, such as for the beneficiary's support and maintenance, medical and health needs, or education. Some trusts allow beneficiaries to request payments from principal.

Powers of Appointment

A trust may grant a power of appointment, usually to the income beneficiary. This power permits the recipient to designate who receives the trust remainder, which, in some cases, will override the default provisions of the trust. There are two classes of powers of appointment: general powers and special powers. A general power gives the holder of the power the right to give the trust property to anyone, including the holder's creditors, the holder's estate, the creditors of the holder's estate, and even directly to the holder.

The IRS considers the holder of a general power of appointment as the owner of the trust property for income and estate tax purposes. For trust law purposes, however, a general power of appointment is not title to property. A general power of appointment only gives the holder the power to designate the property's ultimate owners. Trust property ownership is deemed to pass from the grantor, not from the holder of the general power of appointment. The holder is considered to be only a conduit between the grantor and the remaindermen.

A special power of appointment is limited in scope, may not be exercised in favor of the holder of the power, and is not the equivalent to ownership for tax or other purposes. An example of language conferring a special power to convey property would be "to such of my children and grandchildren as the donee of the power shall designate."

A power of appointment is exercisable by the holder of the power either during the term of the trust (a lifetime power), upon the trust's termination (a testamentary power), or sometimes at both times. If a donee of a power of appointment fails to exercise it in whole or in part, the trust terms that govern disposal of the trust corpus will control.

Spendthrift Clauses

Trust instruments commonly contain spendthrift clauses. Spendthrift clauses are designed to prevent the payment of funds or disbursement of assets to anyone other than the trust's beneficiary and to prevent creditors of the beneficiary from reaching the trust's assets. The clauses may be used in a spendthrift trust to restrict what a beneficiary may do with his or her interest in the trust. For example, a spendthrift provision might be used to prevent a beneficiary from assigning or transferring his or her future interest in a trust to gain present economic value. This would prevent a beneficiary who has not yet attained the age specified in a trust for receiving trust income or assets from pledging future trust benefits in exchange for current acquisitions or consumption (for example, a car). It could also prevent a beneficiary who has poor money management skills from obtaining an immediate cash payment for his or her interest in a trust where the trust was established to provide the beneficiary with steady, lifetime income.

Rule Against Perpetuities

The rule against perpetuities (RAP), which derives from common law, voids any estate or interest that will not take effect or vest within a period established by applicable state law. To comply with traditional state RAP laws, many governing instruments contain a RAP savings

clause requiring the trust to terminate before “the completion of lives in being” (people alive at the time the interest is created) plus an additional 21 years, or before other RAP time frames established by the state law governing that particular trust. The RAP’s underlying objective is to prevent property from being permanently tied up in a trust and to require the property to vest with a person within a discrete period of time. Notable exceptions to the RAP are charitable trusts, which may extend into perpetuity.

Although some level of the RAP remains in effect in most states, a significant number of jurisdictions have repealed some or all of the RAP. Under the laws of these states, individuals may be able to establish “dynasty trusts,” which are intended to continue for many generations in the absence of a state law requirement that they must vest within a certain time period.

Trust Law

Trusts are peculiar to the Anglo-American system of law. English common law established the general framework for what would become U.S. trust law. Trust law in the United States developed through the judicial system rather than through federal or state legislation, although each state has adopted statutes that are specific to trusts.

The principles of common trust law and their application in judicial proceedings over time have been consolidated and interpreted in two primary publications. These publications are the basic guides to common trust law in the United States:

- *Restatement of the Law Third, Trusts*, American Law Institute
- *Scott and Ascher on Trusts*, Fifth Edition

The Uniform Law Commission has adopted a variety of uniform trust statutes that gives states a framework for establishing their trust and probate statutes. A list of the most relevant uniform statutes, which only apply if adopted by a state’s legislature, appears in appendix B, “Uniform Trust Laws,” of this booklet. States typically modify these uniform statutes to accomplish their own legislative objectives.

Upon acceptance of a trusteeship, a bank must administer the trust in accordance with applicable law. When a trust instrument is silent about an issue, consistent with 12 CFR 9.7 for national banks and 12 CFR 150.135 for FSAs, the laws of the state in which the bank acts in a fiduciary capacity for that relationship are deemed the applicable law. State statutes prescribe the scope of a trustee’s powers, duties, responsibilities, and liabilities. Violations of state trust laws and regulations may constitute a breach of trust for which the trustee can be held liable.

During the last two decades, state trust laws have significantly evolved, principally to provide more options to grantors when establishing a trust. Directed trusts, bifurcated trusts, and excluded fiduciary relationships and responsibilities are described in detail in the “Powers and Duties of a Trustee” section of this booklet. Underpinning this effort to update state trust laws is the potential to provide grantors, settlors, and testators greater opportunities

to focus on their specific interests (as well as the ultimate beneficiaries of the trust) by designating multiple parties to represent these interests. The parties to these arrangements may include trustees, investment advisers, distribution advisers, and trust protectors.

The intersection of federal fiduciary regulations (12 CFR 9 for national banks and 12 CFR 150 for FSAs) and state trust laws raise a variety of issues—principally, which set of laws and regulations apply when? National banks and FSAs that operate subject to 12 CFR 9 and 12 CFR 150, respectively, must comply with the core fiduciary requirements set forth in those regulations. Those regulations, in turn, generally refer the bank trustee to applicable law in their definition of what legal standard governs a fiduciary relationship. Because every state has a body of trust law, most personal fiduciary relationships incorporate these legal standards. The actual terms of the instrument serve as the core source of applicable law that governs the fiduciary relationship.

While applicable federal law, state trust law, the trust document, and any relevant court orders are viewed as the primary sources for determining a bank’s fiduciary responsibilities to its trust customers, there are also several core federal regulatory standards. These federal regulatory standards apply to national banks and FSAs that act as fiduciaries, regardless of applicable state trust laws, the trust document, or even any court order pertaining to the fiduciary relationship. These core federal regulatory standards for national banks and FSAs are

- pre-acceptance reviews (12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs).
- dual control for all fiduciary assets (12 CFR 9.13(a) for national banks and 12 CFR 150.230 for FSAs). In addition, to the extent investments of a fiduciary account are maintained off-premises, they must be maintained in a manner consistent with applicable law, and the bank fiduciary must maintain adequate safeguards and controls over those assets.⁴

Before considering which fiduciary standard a bank must apply to a particular account, there are additional core requirements imposed by 12 CFR 9 and 12 CFR 150 that must be met. For example, a bank must have OCC approval or, in limited situations, file a notice with the OCC to exercise fiduciary powers. These powers must be managed by or must be under the direction of the bank’s board of directors. The bank must adopt and follow policies and procedures for preventing self-dealing and conflicts of interest. Fiduciary activities must be audited at least once each calendar year or as part of a continuous audit system consistent with 12 CFR 9.9(b) for national banks and 12 CFR 150.440(b) for FSAs. The “Asset

⁴ The regulatory requirement that the bank maintain adequate safeguards and controls over assets for which the bank acts in a fiduciary capacity applies even in situations, such as under certain directed trusts, when the bank is not directed to have physical custody of the assets. Refer to the “Asset Management Operations and Controls” booklet of the *Comptroller’s Handbook* for a discussion of off-premises custody. Consistent with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs, as part of a bank’s pre-acceptance review process, the bank must ensure that it can properly administer the account. Proper administration of a fiduciary relationship includes the bank’s ability to meet either the physical custody or the adequate safeguards and controls requirements of 12 CFR 9.13(a) for national banks and 12 CFR 150.240 for FSAs.

Management” booklet of the *Comptroller’s Handbook* reviews these requirements imposed on all fiduciary activities offered by national banks and FSAs.

Types of Trusts

The two most common types of trusts are testamentary and living trusts.

Testamentary Trusts

A testamentary trust is established by a testator’s will and takes effect only after passing successfully through the probate process following the testator’s death. Before the testator dies, a testamentary trust can be modified or revoked by changing the will. The trust is not funded until the death of the testator. After the testator dies, a testamentary trust is irrevocable except by court order.

Because the bank is not a party to the creation of the will, a testamentary trust creates no fiduciary obligations for the bank until the will has been probated and the bank accepts the appointment as trustee. Once a trust department accepts the trust, the trust’s terms are binding and help determine the fiduciary’s responsibilities.

Living or Inter Vivos Trusts

A living (inter vivos) trust is created under a trust agreement made effective during the grantor’s lifetime and is used to manage property during the grantor’s life. A living trust may be revocable or irrevocable.

In a revocable living trust, the grantor places property in trust with a trustee but retains the power to withdraw income and principal and change or terminate the trust agreement. The trustee is called upon to act for the benefit of the grantor in the event of incapacity. Upon the grantor’s death, the trust becomes irrevocable and to that extent substitutes for a will as to the property it holds. Assets owned in the trust are distributed after the death of the grantor in accordance with the trust agreement and are not subject to probate administration.

The tax code treats a revocable trust as not involving a transfer of property, because the grantor retains control over the property and receives the benefits from it. There is, therefore, no gift tax when legal title to the property is transferred to the trust, and all income and capital gains are taxed to the grantor. A revocable trust is fully taxable upon the grantor’s death as part of the grantor’s taxable estate. This type of trust can, however, be drafted to enable an executor to take certain actions after the grantor’s death to take advantage of benefits under the tax laws in effect at the time of the grantor’s death.

For example, a husband and wife may each establish revocable trusts, and upon the death of the first spouse, the trust’s assets are directly transferred into one or more credit shelter trusts (refer to appendix A, “Types of Personal Trusts,” of this booklet for more information). Establishing revocable trusts avoids having monies flow, upon the death of one spouse, directly to the surviving spouse and enables the couple to not only maximize the benefits of

both of their individual estate tax exclusions, but also to plan for other contingencies that may arise with blended families, remarriage, or other eventualities.

A revocable living trust has other benefits:

- Trustee may provide professional investment management services.
- Trustee collects income from securities and other investments, manages cash, and distributes income in the manner requested by the grantor or outlined in the governing instrument.
- Trust alleviates the grantor's concern about his or her possible incapacity, because a trustee steps in to handle the grantor's affairs.
- Trust avoids a potentially time-consuming, expensive, and public probate process and protects the privacy of the grantor as well as that of his or her beneficiaries.

An irrevocable living trust represents an unalterable transfer of the grantor's property and creates rights for designated beneficiaries, who may include the grantor. Because an irrevocable trust involves a permanent transfer to the beneficiaries, the grantor may be required to pay gift tax on the transfer of property to the trust. Income paid out of the trust is taxed to the beneficiary who receives it. Income not paid out and accumulated by the trust, including realized capital gains, is taxed to the trust.

An irrevocable living trust is generally not included in the grantor's taxable estate, assuming the grantor did not retain an interest in the trust or a power to change its beneficial interests. The trust property was subject to gift tax when the trust was created, so no estate tax should be due when the grantor dies. If, however, the grantor has set up a grantor trust, the trust may be included in the grantor's taxable estate, and the trustee may be responsible for paying the tax, depending on the tax apportionment clause in the grantor's will.

The trust instrument normally states whether a trust is revocable or irrevocable. If the governing instrument is silent, state law determines the presumption. Historically, irrevocable trusts have been extremely difficult to terminate until the purpose of the trust has been fulfilled. With the adoption of decanting statutes, however, there are now opportunities in some states to modify these trusts.

Refer to appendix A, "Types of Personal Trusts," for more information about personal trusts, including types of grantor trusts, marital deduction trusts, credit shelter trusts, generation-skipping trusts, minor exclusion trusts, charitable trusts, and pre-need funeral trusts.

Powers and Duties of a Trustee

Trustee Powers

A trustee may exercise any power conferred on the trustee by the terms of the trust agreement or applicable statutes without court authorization. The exercise of a power granted to a trustee, however, is subject to the fiduciary duties of a trustee described in this section of the booklet. State trust laws increasingly distinguish among the different capacities of a

corporate trustee. These laws recognize that some trustees are provided broad authority for managing discretionary trusts, including authority to make investment decisions on behalf of the trusts. In other situations, directed trustees or “excluded fiduciaries” (a term used by several recently modified state trust laws) may have more limited powers (and less potential liability). A typical bifurcated trust places some or all investment management responsibility with an investment manager and leaves trust administration with the trustee. Because there is now a broad range of state statutes that authorize a variety of bifurcated relationships in the context of establishing a trust, a bank should consider the implications these various relationships impose on bank trustees before accepting an account. This is particularly important in states that have recently adopted revised trust statutes for which there are few if any legal interpretations regarding a trustee’s duties and residual or additional potential liability under these amended laws.

The trust agreement generally describes the powers given to the trustee and whether such powers are restricted or denied. If the trust instrument is silent concerning a certain power, the trustee should look to applicable state law regarding the power. Generally, a statutory power granted to a trustee is effective unless the governing instrument of the trust expressly forbids its exercise.

If neither the trust instrument nor applicable law expressly gives a particular power to the trustee, such power may be implied from the general terms and purposes of the trust or from express powers granted by the trust agreement or statute. A trustee should request a court ruling to clarify the existence of such power, or, if authorized under the applicable state law version of sections 410 through 417 of the Uniform Trust Code, should seek the consent of each of the beneficiaries before exercising such power.

A grantor may choose to give the trustee discretion in exercising a particular power because of the flexibility such an arrangement provides. Discretionary power may be absolute or limited.

A trustee may directly exercise the powers granted to it, or the trustee may delegate authority to an agent or cotrustee under any of the following circumstances:

- Trust agreement specifically authorizes delegation of the power.
- Applicable statutes authorize delegation of the power.
- Trustee has received the consent of the beneficiaries or a court order authorizing such delegation.

Trustee Duties

All trustees are subject to a broad range of common-law fiduciary duties as well as applicable state fiduciary statutes. Depending on the nature of the trust appointment, a bank may be responsible for fulfilling some or all of these duties when it formally accepts the trustee appointment. When the grantor has established a bifurcated trust, some of these duties (such as prudent investment) may be transferred away from the trustee to the investment manager. Generally recognized duties of a trustee are as follows:

- **Duty of loyalty:** A trustee must administer a trust solely in the interests of the beneficiaries. This is the most fundamental duty of a trustee. A trustee must not engage in any act of self-dealing.
- **Duty of administration:** The trustee must administer the trust in accordance with its terms, purposes, and the interests of the beneficiaries. In the administration of a trust, a trustee must act prudently and exercise reasonable care, skill, and caution. A trustee must only incur reasonable costs of administration.
- **Duty to control and protect trust property:** The trustee must take reasonable steps to take control of and protect the trust property.
- **Duty to keep property separate and maintain adequate records:** A trustee must keep trust property separate from the trustee's property and keep and render clear and accurate records with respect to the administration of the trust.
- **Duty of impartiality:** If a trust has two or more beneficiaries, the trustee must act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests.
- **Duty to enforce and defend claims:** A trustee must take reasonable steps to enforce claims of the trust and to defend claims against the trust.
- **Duty to inform and report:** A trustee must keep qualified beneficiaries reasonably informed about the administration of the trust and the material facts necessary for the beneficiaries to protect their interests. Some jurisdictions impose a duty to provide an accounting to qualified beneficiaries.
- **Duty of prudent investment:** A trustee who invests and manages trust property has a duty to comply with the prudent investor rule unless otherwise stated by the terms of the trust or provided by state law. This duty is tied to the duty to use reasonable care and skill to make the trust property productive.

If a trustee has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, the trustee must use those special skills or expertise while administering the trust.

If a trust requires special skills or expertise that a trustee does not possess, the trustee may delegate certain duties and powers to a third-party vendor if the power to delegate is authorized by applicable law. In addition to complying with the OCC's guidance described in OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," the trustee must comply with applicable law when delegating a duty or power to a third-party vendor. Applicable law generally requires the trustee to use reasonable care, skill, and caution in

- selecting an agent.
- establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust.
- periodically reviewing the agent's actions to monitor the agent's performance and compliance with the terms of the delegation.

Trust Decanting

Trust decanting is a process a trustee may use to modify an irrevocable trust. Decanting has become more common in the past few years as more states have enacted trust legislation authorizing this process. Decanting statutes allow trustees to “pour” assets from an existing trust into a new (or preexisting) trust with different terms and conditions. The ability to modify an irrevocable trust through decanting is useful not only for dealing with problematic or dated trust agreements, but also for changing the home state or situs of a trust.

Because there are potential tax implications associated with decanting a trust, when considering decanting options, the bank should consult tax counsel along with trust counsel having expertise in the relevant state trust decanting statute. A bank that attempts to decant a trust must be particularly careful to establish that the decanting process is of clear benefit to the trust and the ultimate beneficiaries, particularly if the bank charges the decanting expenses to the trust or increases the fees associated with the trust relationship.

Trust Protectors or Trust Advisers

Several states have recently enacted legislation that authorizes the appointment of a trust protector or a trust adviser, a person other than the trustee, beneficiary, or grantor who holds power over one or more attributes of a trust. These include the power to direct investments, in some instances remove or replace the trustee, and/or amend the trust. A protector provision generally provides the protector with limited authority to terminate the trustee as well as the authority to appoint a successor protector. While a protector may be provided with more authority, for example, the ability to not only terminate the trustee but the power to name a new one, this power could lead to a concentration in authority that defeats the underlying purpose of separating the trustee from the trust protector.

Virtual Representation

Under the Uniform Trust Code and many state trust statutes, a minor, incapacitated, unborn, or unascertainable person may, in limited circumstances, be represented by a competent adult who has a substantially identical interest with respect to a particular question or dispute. For example, an adult and minor child may have identical interests in modifying a trust to minimize tax liability or to diversify the trust’s investments. By allowing a minor, for example, to be represented by a parent, the trustee may be able to avoid the time and expense of petitioning a court for the appointment of a guardian ad litem to represent the minor’s interests.

Some states have expanded the traditional scope of virtual representation statutes to allow a broader class of persons to serve as virtual representatives of presumptive remainder beneficiaries. In some jurisdictions, a trustee and virtual representative may now modify an irrevocable trust without obtaining prior court approval, which historically would have been a prerequisite for a modification of such trusts. A bank trustee that relies on a virtual representation statute must take actions to ensure that both the trustee and the virtual

representative are authorized under the applicable law to take the intended action on behalf of the individual, or class of individuals, they purport to represent.

Investment Accounts

Investment Management Accounts

Banks are significant providers of fiduciary investment services for personal clients. A bank may provide discretionary investment management services, or it may only provide investment advice for a fee, with limited or no investment discretion. Investment accounts for which the bank has investment discretion or for which the bank provides investment advice for a fee are defined as fiduciary accounts by the OCC in 12 CFR 9 for national banks and 12 CFR 150 for FSAs, and are subject to OCC fiduciary regulation.

In a discretionary investment agency account, the bank is given the sole or shared authority to purchase and sell assets and execute transactions for the benefit of the principal, in addition to providing investment advice. The bank's investment authority is usually subject to investment policy guidelines established in the investment account contract. The bank does not receive legal title to the assets in the investment account as it would if the bank served as trustee for a trust.

In an investment advisory account, the bank may provide portfolio management and advisory services for a fee. These services may include investment analysis and advice, trade processing, performance measurement, and securities safekeeping and custody.

The "Investment Management Services" booklet of the *Comptroller's Handbook* provides additional supervisory guidance for investment accounts.

Investment Advisory Accounts

In addition to acting as trustee on an account or managing a customer's investments, a bank may be hired by a customer as his or her investment advisory agent to provide investment advice. Providing investment advice for a fee is defined in 12 CFR 9.2(e) for national banks and 12 CFR 150.30(j) for FSAs as a fiduciary capacity subject to applicable regulatory requirements. Even though a bank is only providing investment advice for a fee, and there are no assets to manage or place in custody and no account is opened on the bank's trust accounting system, the bank must still comply with core fiduciary requirements, including pre-acceptance review, annual audit, and adherence to fiduciary policies and procedures. For a more detailed discussion of the core fiduciary requirements, refer to the "Asset Management" booklet of the *Comptroller's Handbook*.

To the extent a bank is providing investment advice for a fee by offering an investment model to a customer, the bank should adhere to the guidance in OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management." The "Investment Management Services" booklet of the *Comptroller's*

Handbook provides additional guidance on model risk when developing investment recommendations.

OCC Interpretation 12 CFR 9.101 provides a list of specific activities that the OCC does not consider to be “providing investment advice for a fee.” Accordingly, the following activities are not considered to be examples of acting in a fiduciary capacity and therefore are not subject to 12 CFR 9 for national banks and 12 CFR 150 for FSAs:

- Financial advisory and counseling activities, including strategic planning of a financial nature, merger and acquisition advisory services, advisory and structuring services related to project financing transactions, and providing market economic information to customers in general.
- Client-directed investment activities (i.e., the bank has no investment discretion) when investment advice and research may be made available to the client but the fee does not depend on the provision of investment advice.
- Investment advisory activities incidental to acting as a municipal securities dealer.
- Real estate management services provided to other banks or other financial institutions.
- Real estate consulting services, including acting as a finder in locating, analyzing, and making recommendations regarding the purchase of property, and making recommendations concerning the sale of property.
- Advisory activities concerning bridge loans.
- Advisory activities for homeowners associations.
- Advisory activities concerning tax planning and structuring.
- Investment advisory activities authorized by the OCC under 12 USC 24(Seventh) as incidental to the business of banking.

Given the legal significance of having an activity identified as acting in a fiduciary capacity, a bank that accepts a relationship in which the bank is only providing investment advice for a fee must make a determination whether that account is to be treated as fiduciary.

Risks Associated With Personal Fiduciary Activities

From a supervisory perspective, risk is the potential that events, expected or unexpected, will have an adverse effect on a bank’s earnings, capital, or franchise or enterprise value. The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of this interdependence and assess the effect in a consistent and inclusive manner. Refer to the “Bank Supervision Process” booklet of the *Comptroller’s Handbook* for an expanded discussion of banking risks and their definitions.

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. The types and level of risk are potentially extensive because each personal fiduciary account is a separate legal relationship that involves unique client

characteristics and fiduciary duties and responsibilities. In most cases, the risks associated with personal fiduciary activities are operational, compliance, reputation, and strategic.

Operational Risk

Operational risk is inherent in the provision and administration of personal fiduciary activities. When serving as a fiduciary, a bank is normally responsible for processing and reporting many types of transactions and a large part of a bank's revenue may come from these transactions. The personal fiduciary business is, by its nature, operationally intensive, and a fiduciary's success depends on how well that fiduciary gathers, processes, and reports transactions and information.

Examples of transactions, accountings, and information reports are

- acceptance and establishment of accounts.
- receipt and disbursement of account income.
- purchase, sale, valuation, and performance measurement of account investments.
- review and execution of discretionary account distributions.
- maintenance of account financial records and the preparation and distribution of client statements.
- preparation and submission of account tax returns and related reports.
- preparation of internal financial records and information reports.

The record-keeping, accounting, and reporting systems necessary to operate a profitable personal fiduciary business can be complex and expensive to acquire and maintain. A bank should have fiduciary information systems and internal controls appropriate to the types and levels of risk inherent in each of the personal fiduciary activities the bank provides. A bank also should have an adequate and well-trained staff.

For a detailed description of the operational risks associated with engaging in asset management activities, including risks associated with serving in a fiduciary capacity, refer to the "Asset Management Operations and Controls" booklet of the *Comptroller's Handbook*. To the extent that these activities are outsourced to third-party vendors, the risks to the bank are likely to increase because the bank depends on each vendor not only to accurately execute or document each transaction on a timely basis, but also to maintain the confidentiality of each transaction. Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," for a detailed discussion of these risks.

Account losses that result from a bank's failure to properly safeguard assets from loss or damage or that arise from processing transactions can lead to other risks, such as compliance (violations of applicable law or client litigation) and reputation (loss of business). Financial losses can be large in relation to a bank's earnings and capital. A damaged reputation from poor management of operational risk can significantly harm a bank's ability to compete and be financially successful in the personal fiduciary business.

Compliance Risk

A bank that does not comply with applicable law can suffer lawsuits, regulatory action, and severe damage to its reputation. The financial impact of litigation, regulatory action, and criminal activity is difficult to estimate, but the impact can be significant in relation to earnings and capital. Additionally, such adverse situations may be highly publicized in the bank's market area and could further damage a bank's reputation.

A bank fiduciary must comply with the terms of the governing document (assuming such terms are legal) that establishes the fiduciary relationship. Based on the specific terms of the governing document and the role or roles assigned to the bank as trustee, the bank's responsibilities may differ greatly. For more information about state laws applicable to the trust relationship, refer to appendix B, "Uniform Trust Laws," of this booklet. Trust agreements, wills, agency agreements, and court orders establish legal relationships that set forth the fiduciary's duties and obligations. These are legally enforceable documents, and failing to comply with them can result in litigation and financial losses.

A bank fiduciary must comply with a multitude of federal, state, and local laws and regulations to which the bank and each individual account are subject. These include trust investment law, securities law, banking law, tax law, contract law, bank secrecy law, environmental law, consumer protection law, criminal law, and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) laws and regulations. The various federal and state courts have long held corporate fiduciaries to the highest standard of care.

Bank personnel must comply with applicable bank policies and internal operating procedures and control systems. Personal fiduciary account administration can be complex and requires sound legal expertise, an ethical and highly trained staff, and an effective internal control system. Failing to comply with internal policies and procedures can lead to poor risk selection, strategic business failure, wasted financial resources, client lawsuits, and increased regulatory oversight.

Strategic Risk

A bank's personal fiduciary activities business can be an important component of profitability and shareholder value. Financial success requires a sound strategic planning process embraced by the bank's board and senior management. The business requires a substantial provision of financial, human, and technological resources. Expenditures for personnel, information systems, product development and distribution channels, and internal control systems should be appropriate for the diversity and complexity of a bank's fiduciary operations. Inadequate strategic planning and business plan implementation can lead to poor earnings performance, wasted capital, and diminished shareholder value.

As part of the strategic planning process in the personal fiduciary area, a bank needs to consider the specific activities and risks associated with the activities it undertakes. For example, if a bank plans to expand its personal fiduciary offerings, particularly by offering

products such as pre-need funeral trusts, viatical settlements,⁵ or special needs trusts, the bank should consider the enhanced risks it would assume by offering these products. A strategic decision to expand personal fiduciary services to consumers who may lack the financial resources and background to fully appreciate the risks associated with these products poses heightened risks to the bank. Particularly in states that have recently amended their trust laws, or for banks that decide to expand the personal trust options they offer their customers, banks should consider the strategic risks associated with these decisions. A bank's strategic decision to offer trusts that rely on provisions of recently modified state laws that allow for trust decanting, virtual representation, trust protectors, or other nontraditional trust concepts introduces heightened risks. This is particularly true in states where the state courts have not yet had an opportunity to interpret these new statutory trust law provisions.

Reputation Risk

A bank's success in providing personal fiduciary activities depends on the quality of its reputation with current and prospective clients and the general marketplace. Because a high degree of trust is implicit in any fiduciary relationship, a sound reputation is essential to attract and retain personal fiduciary accounts. Personal clients are demanding in terms of expected investment performance, product selection, information reporting, service, and the use of advanced technology. Competition for personal clients is very strong, and negative publicity, deserved or not, can damage a bank's ability to compete. In particular, disputes with account beneficiaries, especially when publicized, can increase reputation risk.

A bank's reputation in the marketplace depends on the bank's ability to effectively manage operational, compliance, and strategic risks, as well as the financial risks of each personal fiduciary account. Litigation, regulatory action, criminal activity, inadequate products and services, below-average investment performance, poor service quality, or weak strategic initiatives and planning can lead to a diminished reputation and, consequently, to an inability to compete and be successful.

Risk Management

The OCC expects each bank to identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for its size and the complexity of its operations. When examiners assess the effectiveness of a bank's risk management system, they consider the bank's policies, processes, personnel, and control systems. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

This section of the booklet describes how banks should manage risks associated with personal fiduciary activities. Because risk strategies and organizational structures vary, no

⁵ A viatical settlement is an arrangement by which the owner of a life insurance policy (who is typically facing a terminal illness) sells his or her policy to a third party for a lump sum amount. The lump sum amount exceeds the policy's cash surrender value but is less than the value of the policy's death benefit. Upon acquiring the policy, the purchaser makes the premium payments on the policy until the insured dies. Upon the death of the insured, the purchaser receives the policy's full death benefit from the insurance carrier.

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 escheat⁶ 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

⁶ 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

expectations of the bank's different types of personal fiduciary clients and their portfolios and identify the applicable risks. Managers can then estimate the level of risk affecting particular clients, risks that span the personal fiduciary area, and ultimately risks arising from relationships that may affect the bank.

To facilitate the identification and understanding of relevant risks, a bank should clarify what type of risk measurement and reporting processes it expects from account managers, third-party service providers, and investment counterparties. As discussed in greater detail in the "Investment Management Services" booklet of the *Comptroller's Handbook*, risks vary over time because of changes in client characteristics and needs, portfolio composition, bank strategies, as well as domestic and global capital markets. Accordingly, when assessing investment management risk in personal fiduciary accounts, some risk assessments should be ongoing or open-ended, others should take place on a periodic basis, while others would only occur in response to significant changes.

As discussed in the "Investment Management Services" booklet, questions to consider when assessing the risks in a personal fiduciary investment portfolio include: how is portfolio valuation conducted and what type of investment performance reports are prepared; are the securities on an approved security investment list; does the portfolio rely on asset allocation modeling and related criteria; are there red flags in the investment policy exception reports; and how does the bank evaluate equity and fixed-income statistics and related commentary in the context of making investments for personal fiduciary accounts?

Record Keeping and Document Security

In accordance with 12 CFR 9.8 for national banks and 12 CFR 150.410 through 12 CFR 150.430 for FSAs, a bank must

- adequately document the establishment and termination of each fiduciary account and maintain adequate records.
- retain fiduciary account records for a period of three years from the later of the termination of the account or the termination of litigation relating to the account.
- ensure that fiduciary account records are separate and distinct from other records of the bank.

The fiduciary is expected to have sound controls over the governing instrument and other original documents. The controls should ensure that original documents filed with court authorities are properly authenticated and preserved for future accountings. Copies may be retained in account files, but original documentation, or legally acceptable electronic records (as authorized by OCC Advisory Letter 2004-9, "Electronic Record Keeping," for national banks), should be maintained in a centrally controlled location. Original board and committee minutes, with attachments noting approvals and actions taken, should receive the same level of safeguarding.

Periodic Account Reviews

12 CFR 9.6(c) for national banks and 12 CFR 150.220 for FSAs require banks to conduct reviews at least once during each calendar year of all assets of each fiduciary account for which the banks have investment discretion. As detailed in OCC Bulletin 2008-10, “Fiduciary Activities of National Banks: Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6(c),” the review must determine whether account assets are appropriate, individually and collectively, for the account. The review, typically undertaken by a bank’s fiduciary committee, should consider the account’s investment policy statement, analyze investment performance, and reaffirm or change the investment policy statement, including asset allocation guidelines. If certain assets are no longer appropriate for the account, those assets should be replaced consistent with prudent investment practices. Items to consider include account objectives, needs of beneficiaries, and income tax consequences.

The annual investment review process has evolved over time. While a bank that relies on automated systems may have the ability to screen an account’s marketable securities on a daily basis, a manual investment review process provides a more hands-on approach to investment reviews. Marketable securities and unique assets usually are reviewed at the same time, which can allow for more dialogue among administrators, portfolio managers, and unique asset managers.

An automated investment review can be a useful investment management and compliance tool. Lower-risk accounts, such as those invested in model portfolios comprising mutual funds or collective investment funds, lend themselves well to an automated process. An automated system allows marketable securities to be screened efficiently and frequently to identify assets not on an approved list, concentrations, own-bank securities, or accounts with allocations inconsistent with account objectives. While automation can provide efficient identification, reporting, escalation, and ongoing monitoring of many types of exceptions, an automated investment review is not a substitute for good portfolio management or committee oversight and accountability.

Fiduciaries are also expected to perform periodic administrative account reviews to determine whether the account is being administered in accordance with the terms and conditions of the governing instrument. Periodic administrative reviews are particularly important to ensure that the account is properly coded in the bank’s trust accounting system, that distributions are made in conformance with the governing instrument or state law, and that any account changes are properly captured by the bank’s systems. While there are no specific regulatory requirements establishing a cycle for administrative reviews, each bank should consider the risks inherent in the various account relationships the bank accepts and should review its accounts accordingly. While administrative reviews are not necessarily conducted by a fiduciary committee, any exceptions should be tracked to resolution and should be escalated to the committee level, particularly when no corrective action is taken.

A bank that identifies errors in its administration of fiduciary accounts needs to accelerate its review cycles to ensure the bank has systems in place to identify and eliminate errors in both the affected accounts as well as systemically. Account reviews are generally undertaken by

an administrative officer working with a designated investment manager or adviser. The reviews are normally submitted to and reviewed by the appropriate fiduciary committee. A review of BSA/AML issues should occur as part of the administrative review of account transactions, particularly consideration of actual versus anticipated account activity.

Discretionary Distributions

A discretionary distribution power gives a trustee the authority to determine the amount and types of distributions and, in some cases, to select the beneficiaries from among a class or several classes of beneficiaries. Making discretionary distributions is a risky and challenging responsibility for the trustee. Exercising this power may mean that one beneficiary, such as the income beneficiary receiving a distribution of principal, receives a benefit, while another, typically the remainderman, does not. Close attention to the applicable state statute governing principal and income distribution is particularly important for most trust relationships. A bank's discretionary distribution policy establishes how these distributions are to be handled and who has the authority to make them. As the level of discretionary disbursements increases, bank policy typically imposes additional hurdles to ensure adherence to applicable legal requirements. Unusually large discretionary distributions and other novel situations are generally presented to a fiduciary committee to ensure the bank is not assuming undue risk.

The proper use of a discretionary power requires sound judgment and a clear understanding of the terms of the trust, the grantor's intention, and the beneficiaries' best interests. A trustee with discretionary distribution power must fully comply with the income payout and principal invasion standards established by the trust agreement. Failure to do so may violate the trustee's duty of impartiality and constitute a breach of trust. As discussed in the "Trustee Powers" section of this booklet, bifurcated or directed trusts are designed to reduce, and in some cases, eliminate these issues for a trustee to the extent investment management and distribution responsibilities are assigned to other parties.

For most trust relationships, however, effective risk management requires a process to ensure that the decision to make a discretionary distribution is based on standards that are fair to both the income and principal beneficiaries. Bank trustees may handle discretionary distributions in various ways, usually dependent on size of the department and types of accounts administered. Bank policy may limit the dollar amount of discretionary distributions that account administrators can make without a higher-level approval. Alternatively, all distributions may have to be approved by a designated fiduciary committee. All discretionary distribution decisions should be adequately supported, documented, and approved by an authorized authority.

Tax Issues

In addition to managing a trust, bank trust departments generally prepare the required federal and state fiduciary income tax returns for a trust each year, and where required, federal and state estate and gift or inheritance tax returns. In addition, they may advise beneficiaries regarding the tax implications of trust or estate distributions. Bank personnel working in this area (or third parties retained to perform this function) should be experts in the field as the

risks to both the bank and their trust and estate customers are high if inaccurate tax returns are submitted.

Both income and estate tax laws are in constant flux. While some changes in these laws are relatively clear-cut (for example, the tax rate or the amount of an estate tax exemption), others are nuanced and are subject to interpretation. One facet of the federal tax code that has been particularly unsettled involves expense-related deductions paid by personal trusts and estates. The IRS recently issued 26 CFR 1.67-4 (costs paid or incurred by estates or non-grantor trusts) that establishes clearer standards in this area. Pursuant to this regulation, some expenses (such as certain tax returns, fiduciary expenses, and many appraisal fees) may be fully deducted, while other expenses (many investment advisory fees, appraisal fees to obtain insurance rather than to determine the fair market value of assets as of an individual's date of death) are subject to a 2 percent floor. Some expenses are bundled and the fees and expenses have to be allocated between those subject to the 2 percent floor and those that are not. A bank should have the systems in place to track the expenses associated with each trust and estate it administers, and to accurately allocate these expenses for tax purposes.

Client Communication

Good customer service is often the difference between success and failure in the personal fiduciary service business. Most fiduciaries attest to the benefits of good communication with account principals, beneficiaries, and co-fiduciaries. Consumer complaints and threatened litigation are frequently a direct result of a lack of transparency and inadequate communication of policies, responsibilities, account objectives and strategies, and other client expectations.

The bank fiduciary should have a system to ensure that a bank representative periodically contacts account principals and beneficiaries to determine whether their financial objectives and circumstances have changed. During such communication, the bank representative should review the account's purpose and investment policy and determine whether the account is being administered in a prudent manner and solely in the best interests of the client.

Other Compliance Issues

Personal fiduciary activities are subject to the BSA, also known as the Currency and Foreign Transactions Reporting Act, and the Financial Crimes Enforcement Network's implementing regulation, 31 CFR Chapter X. A bank must establish policies and procedures to ensure that fiduciary activities comply with the BSA and AML laws and regulations, including the USA Patriot Act of 2001. The *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual* provides a comprehensive overview of the BSA and AML laws and regulations.

Certain fiduciary customers are covered by Title V of the Gramm–Leach–Bliley Act of 1999, as amended by Title X of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, which sets forth provisions addressing the obligations of a financial institution with respect to the privacy of consumers' nonpublic personal information. The implementing

regulations of the Consumer Financial Protection Bureau, 12 CFR 1016, “Privacy of Consumer Financial Information” also apply to these fiduciary customers. A bank must ensure that it complies with 12 CFR 1016’s notice and disclosure requirements as the privacy regulation applies to covered fiduciary accounts. Some states also have consumer privacy laws and constitutional protections that must be followed.

Consumer protection statutes and regulations may apply to the activities of personal trusts. A bank is responsible for ensuring that a trust for which it serves as trustee complies with applicable consumer protection laws and regulations. Failure to do so can result in a breach of the bank’s fiduciary responsibilities, administrative and beneficiary litigation, and financial and reputation damage to the bank. The “Asset Management” booklet and the “Consumer Compliance” series booklets of the *Comptroller’s Handbook* provide an overview of consumer protection laws and regulations applicable to personal fiduciary accounts. The OCC generally supervises compliance with the broad range of consumer laws and regulations through its consumer compliance examination process.

Account Termination

Accounts may be terminated for a variety of reasons. For example, a personal trust may terminate at a specified time or upon the occurrence of a specified event. In some states, a trust’s duration is governed by the RAP (21 years past the last beneficiary’s death, plus nine months). Several states, however, have modified or repealed that rule, giving trusts in those states no legal ending date. When an account must be terminated, the fiduciary is responsible for terminating the account, distributing the remaining assets, and preparing and filing required reports. Risk control processes should be just as strong when terminating accounts as when accepting them.

The governing instrument controls the form and manner of asset distribution. If the instrument is silent as to the form of distribution, the fiduciary is responsible for producing a plan of distribution. This plan should be approved internally and submitted to the beneficiaries. The plan should consider such factors as

- type and value of assets.
- difficulties in dividing the assets.
- distributions in cash or in kind.
- tax consequences.
- releases.
- timing of distributions.
- needs and circumstances of the remaindermen.
- judicial and beneficiary accountings.

Applicable law may require judicial filings that generate a release of the fiduciary from its obligations. A judicial accounting is often desirable in certain complex accounts even when not required by law. The accounting binds all of the remaindermen. Often, and particularly in the case of small, noncomplex trust accounts, a trust account may be closed with receipt and release agreements.

Management Information Systems

Efficient and effective risk management requires a fiduciary information system that is timely, accurate, relevant, useful, and appropriate for the size and complexity of the fiduciary organization. Appropriate internal controls and financial and human resources should be provided to maintain and protect the bank's information systems. The board and management should have adequate information systems to assess, control, and monitor risk from personal fiduciary accounts. The following are some examples of appropriate information systems

- Financial record-keeping systems such as an automated accounting system designed for the administration and operation of trust accounts.
- Senior management information reports to monitor risk, compliance with policies, and the financial performance of the business. These include financial, audit, compliance, control self-assessments, and legal reports.
- Administrative reports to keep track of the day-to-day administration requirements for each account. These would include cash management reports, delinquency reports, transaction reports, and other types of tickler reports.
- Investment performance reports such as portfolio reviews and transaction reports.
- Customer statements and presentations to report investment holdings, transactions, and performance.

Control Systems

A bank should have appropriate control systems in place to assess the effectiveness of the processes it has implemented to manage its personal fiduciary accounts and activities. In addition, control systems such as effective audit and compliance functions and management information systems (MIS) are required to prevent, detect, monitor, and escalate potential issues associated with this line of business.

Compliance

A compliance function commensurate with the nature and scope of a bank's personal fiduciary activities is a key element in the bank's risk management system. An effective compliance program for managing these accounts should include

- identification of all laws and regulations relating to personal fiduciary activities.
- appropriate reporting and escalation of exceptions to applicable laws, regulations, governing instruments, and bank policies.
- periodic review and testing to ensure adherence to laws, regulations, governing instruments, and bank policies.
- periodic self-assessments to determine the risks associated with the bank's personal fiduciary activities and the quality of the bank's current controls.

A bank's MIS and related processes should provide adequate information, including operation reports, to alert staff to exceptions to applicable law or bank policies, and ensure

that they are reported to the appropriate officers, employees, and supervisory committees. Effective MIS identify specific personal fiduciary accounts or activities, provide meaningful summary information, and highlight exceptions that represent potential violations of applicable law or that exceed a bank's risk appetite.

A bank's MIS and related processes should enable management and the board to effectively

- determine whether acceptance of specific personal fiduciary accounts or assets are permissible under applicable law and consistent with the bank's policies and risk appetite.
- monitor and ensure appropriate resolution of any issues associated with the personal fiduciary business line that may be inconsistent with the bank's policies or risk appetite.
- evaluate the level of risk to the bank from accepting specific new personal fiduciary accounts or business.
- determine the bank's aggregate risk associated with its personal fiduciary activities.

Audit

An effective audit program is essential to ensuring that the controls and processes implemented to manage the bank's personal fiduciary accounts and activities work properly. To ensure that a suitable fiduciary audit is performed in accordance with 12 CFR 9.9 (national banks) or 12 CFR 150.440 through 12 CFR 150.480 (FSAs), the board of directors must assess whether the audit programs in place are adequate to determine whether personal fiduciary accounts are managed in accordance with applicable law and with bank policies and procedures. Refer to the "Internal and External Audits" booklets of the *Comptroller's Handbook* for more thorough discussions of this topic.

Examination Procedures

This booklet contains expanded procedures for examining specialized activities or specific products or services that warrant extra attention beyond the core assessment contained in the “Community Bank Supervision,” “Large Bank Supervision,” and “Federal Branches and Agencies Supervision” booklets of the *Comptroller’s Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

Scope

These procedures are designed to help examiners tailor the examination to certain banks and determine the scope of the personal fiduciary activities examination. This determination should consider work performed by internal and external auditors, other independent risk control functions, and by other examiners in related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the objectives in this section. Seldom will every objective or step of the expanded procedures be necessary.

Objective: To determine the scope of the examination of personal fiduciary activities and identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following sources of information and note any previously identified problems related to personal fiduciary activities that require follow-up:
 - Supervisory strategy
 - The OCC’s Financial Institution Data Retrieval System
 - Previous reports of examination and work papers
 - Internal and external audit reports and work papers
 - Bank management’s responses to previous reports of examination and audit reports
 - Customer complaints and litigation
2. Obtain the results of reports such as call report Schedule RC-T, “Fiduciary and Related Services,” and the Uniform Bank Performance Reports.
3. Obtain and review policies, procedures, and reports bank management uses to supervise personal fiduciary activities, including internal risk assessments and compliance reviews.
4. In discussions with bank management, determine whether there have been any significant changes—for example, in policies, processes, and personnel (including key fiduciary and operational staff), control systems (such as the audit plan), third-party relationships, products, services, delivery channels, volumes, markets, and geographies, board and fiduciary committee structure and oversight, or operating systems—since the last examination of personal fiduciary activities.

5. Based on an analysis of information obtained in the previous steps, as well as input from the examiner-in-charge (EIC), determine the scope and objectives of the personal fiduciary activities examination.
6. Select from the following examination procedures the necessary steps to meet examination objectives and the supervisory strategy.

Quantity of Risk

Conclusion: The quantity of each associated risk is
(low, moderate, or high).

To determine the quantity of a particular risk, examiners may select a sample of personal fiduciary accounts for review. If possible, include a variety of fiduciary account types and bank capacities. Determine in what capacity the bank is acting with regard to each personal fiduciary account and, based on that capacity, determine what legal and contractual obligations the bank has to the various parties to the account and what products and services the bank is providing the account.

Objective: To determine the quantity of operational risk from the bank's delivery and administration of personal fiduciary activities.

1. Obtain and analyze management information reports relating to transaction processing and reporting within the bank's personal fiduciary department or organization. Consider the following:
 - Volume, trend, type, and complexity of transactions, products, and services offered through the bank.
 - Condition, security, capacity, and recoverability of systems.
 - Complexity and volume of conversions, integrations, and system changes.
 - Development of new markets, products, services, technology, and delivery systems to maintain competitive position and gain strategic advantage.
 - Volume, trend, and severity of operational, administrative, and accounting control exceptions and losses from fraud and operating errors.
 - Impact of infrastructure threats on the bank's ability to deliver timely support and service.
 - Ability of service providers to maintain the level of service that the bank requires.

2. Obtain and review the most recently completed information technology examination activity:
 - Discuss any findings and recommendations relating to personal fiduciary activities with bank management.
 - Determine whether commitments for corrective action or other recommendations have been adequately addressed by the organization.

Objective: To determine the quantity of compliance risk from the bank's delivery and administration of personal fiduciary activities.

1. Obtain and analyze the volume, trend, and significance of noncompliance and nonconformance with policies and procedures, applicable law, and basic fiduciary principles that have been identified and reported in the following sources:

- Board and committee minutes and reports.
 - Risk management and compliance reports.
 - Control self-assessment reports.
 - Internal and external audit reports.
 - Regulatory reports.
 - Other OCC examination programs.
2. Obtain and analyze the volume, trend, and significance of litigation and consumer complaints related to personal fiduciary accounts. Discuss significant litigation and complaints with bank management. Determine the risk to capital and the appropriateness of corrective action and follow-up processes.
 3. Incorporate the findings of the account sampling and testing into the assessment of compliance risk. Consider the level of compliance with
 - the governing instrument.
 - applicable state trust law.
 - court orders.
 - 12 CFR 9 for national banks, 12 CFR 150 for FSAs, and other applicable federal statutes and regulations.
 - bank policies and operating procedures.

Objective: To identify and estimate the level of strategic risk inherent in the bank’s delivery and administration of personal fiduciary activities.

1. Obtain and analyze the bank’s strategic plan for personal fiduciary activities, particularly new trust relationships authorized under state law, such as directed or bifurcated trusts. Consider the following strategic factors:
 - Magnitude of change in established corporate mission, goals, culture, values, or risk appetite.
 - Financial objectives as they relate to the bank’s short- and long-term goals.
 - Market situation, including product, customer demographics, geographic position, and multi-state operations.
 - Diversification by product, geography, and customer demographics.
 - Past performance in offering new products and services.
 - Risk of implementing innovative or unproven services, or technologies.
 - Nature, complexity, and extent of new fiduciary business activities, including products and services, particularly directed or bifurcated trust relationships.
 - Maintenance of an appropriate balance between technological innovation and secure operations.
 - Merger and acquisition plans and opportunities.
 - Potential or planned entrance into new delivery channels or implementation of new systems.

2. Discuss with management and reach conclusions about the effect of external factors on strategic risk. Consider the following external factors:
 - Economic, industry, and market conditions
 - Legislative and regulatory changes
 - Technological advances
 - Competition

3. Analyze and discuss with management how strategic assessment factors affect the level of strategic risk related to personal fiduciary activities. Consider the following strategic assessment factors:
 - Expertise of senior management in committing to new activities and the effectiveness of the board to oversee these activities.
 - Reliance on enhanced legal authority or novel legal statutes or interpretations to offer different personal fiduciary services or products.
 - Priority and compatibility of personnel, technology, and capital resources allocation with strategic initiatives.
 - Past performance in offering new products or services and evaluating potential and consummated acquisitions.
 - Performance in implementing new technology or systems that affect personal fiduciary activities.

Objective: To identify and estimate the level of reputation risk from the bank's delivery and administration of personal fiduciary activities.

1. Analyze and discuss with management how certain factors affect reputation risk related to personal fiduciary activities. Consider the following factors:
 - Volume, trend, and type of assets and number of accounts under management or administration.
 - Merger and acquisition plans and opportunities.
 - Multi-state fiduciary operations.
 - Potential or planned entrance into new businesses, product lines, or technologies (including new delivery channels), particularly those related to directed or bifurcated trusts.
 - Past performance in offering new products or services and in conducting due diligence before startup.
 - Past performance in developing or implementing new technologies and systems.
 - Nature and amount of litigation and customer complaints.
 - Expertise of senior management and the effectiveness of the board in maintaining an ethical, self-policing culture.
 - Management's willingness and ability to adjust strategies based on regulatory changes, market disruptions, market or public perception, and operational as well as litigation losses.

- Quality and integrity of MIS and the development of expanded or newly integrated systems.
 - Adequacy and independence of internal control.
 - Responsiveness to deficiencies in internal control.
 - Ability to minimize exposure from litigation and customer complaints.
 - Ability to communicate effectively with the market, public, and media.
 - Policies, practices, and systems protecting information that customers might consider private or confidential from deliberate or accidental disclosure.
 - Management's responsiveness to internal, external, and regulatory review findings.
2. Analyze and discuss with management how the impact of certain external factors affect reputation risk related to personal fiduciary activities. Consider the following factors:
- Market's or public's perception of the corporate mission, culture, and risk tolerance of the bank.
 - Market's or public's perception of the bank's financial stability.
 - Market's or public's perception of the quality of products and services offered by the bank.
 - Impact of economic, industry, and market conditions; legislative and regulatory change; technological advances; and competition.

Reach a conclusion on the types and quantity of risk from personal fiduciary activities based on the findings of these and other related examination activities.

Quality of Risk Management

Conclusion: The quality of risk management is (strong, satisfactory, or weak).

The conclusion on risk management considers all risks associated with personal fiduciary activities.

Select a sample of personal fiduciary accounts for review. If possible, include a variety of account types and bank capacities. Determine in what capacity the bank is acting with regard to each personal fiduciary account and, based on that capacity, determine what legal and contractual obligations the bank has to the various parties to the account and what products and services the bank is providing the account.

Policies

Policies are statements of actions adopted by a bank to pursue certain objectives. Policies often set standards (on risk tolerances, for example) and should be consistent with the bank's underlying mission, values, and principles. A policy review should always be triggered when the bank's objectives or standards change.

Objective: To determine whether the board has adopted effective policies that are consistent with safe and sound banking practices and appropriate to the size, nature, and scope of the bank's personal fiduciary activities.

1. Evaluate relevant policies to determine whether they provide appropriate guidance for managing the bank's personal fiduciary activities and are consistent with the bank's mission, values, and principles.
2. Determine whether policies establish risk limits or positions and delineate prudent actions to be taken if the limits are exceeded.
3. Verify that the board of directors periodically reviews and approves the bank's personal fiduciary activities policies.
4. Evaluate the policies and procedures. Consider the following:
 - Do the policies adequately address applicable law, including state trust law, the terms of the instrument governing the personal fiduciary relationship, and 12 CFR 9 for national banks and 12 CFR 150 for FSAs?
 - Do the policies require trust officers to establish objectives for each account and to periodically ensure that the core account objectives (both investment and strategic) of the account are being met?
 - Do the policies establish a risk management and internal control framework that addresses the following?

- Organizational and functional charts
- Defined lines of authority and responsibility
- Delegation authority and approval processes
- Processes to select, employ, and evaluate legal counsel
- Standards for dealings with affiliated organizations
- Personnel practices
- Do the policies establish a cycle for administrative reviews of personal fiduciary accounts, including confirmation that current and accurate information about the client, the client’s family and/or beneficiaries, and the client’s long- and short-term goals are maintained in the file?
- Do the policies include appropriate account acceptance and administration guidelines that address
 - new account acceptance processes, particularly for directed trusts and bifurcated accounts?
 - new account acceptance processes for accounts in which custody of fiduciary assets is to be maintained off-premises, or when the bank uses a subcustodian?
 - account reviews?
 - discretionary distributions?
 - investment reviews?
 - cash management?
 - BSA compliance and AML controls?
 - customer information privacy?
 - fees and other expenses?
 - tax preparation and reporting?
 - account closings?
- Do the policies effectively address MIS and technology applications? Consider the following:
 - Accounting and other transaction record-keeping systems
 - MIS requirements
 - Customer information security
 - Systems security and disaster contingency plans
- Do the policies identify relevant federal and state income, inheritance, gift, and estate tax issues?
- Do the policies establish
 - policy exception definitions and guidelines?
 - policy exception tracking and reporting processes?
 - client reporting guidelines?
 - control self-assessment processes?
 - customer complaint resolution procedures?

Processes

Processes are the procedures, programs, and practices that impose order on a bank’s pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are

consistent with the underlying policies and are governed by appropriate checks and balances (such as internal controls).

Objective: To determine whether the bank has processes in place to define how personal fiduciary activities are carried out.

1. Evaluate whether processes are effective, consistent with underlying policies, and effectively communicated to appropriate staff.
2. Evaluate the bank's account acceptance process. Consider the following:
 - Is the process formalized and adequately documented?
 - Is appropriate information obtained during the due diligence review and effectively used in the approval process?
 - Is the process complied with?
 - Does it include an appropriate approval process for policy exceptions?
 - Does it comply with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs (pre-acceptance reviews)?
3. Select a sample of recently accepted personal fiduciary accounts for review. If possible, include a variety of account types including successor trustee and cotrustee accounts, directed or bifurcated trust relationships (if the bank accepts these accounts), as well as traditional personal fiduciary accounts. For each selected account, determine whether the account acceptance process was effective and adequately considered relevant factors, including
 - bank's level of technical expertise and operational capabilities.
 - bank's proposed fiduciary duties and obligations and the limits of each party's status as agent or fiduciary, particularly in light of any applicable state statute affecting directed trustees or bifurcated fiduciary relationships.
 - terms and conditions of the governing instrument and how the account parties are characterized.
 - current or foreseeable problems in administering the account.
 - BSA/AML reviews and OFAC screening.
 - the adequacy of compensation for accepting the risks from administering the account.
 - the types of assets currently in the portfolio and the types of assets to be purchased and managed in the portfolio.
 - environmental review issues.
 - input from portfolio managers, risk managers, and legal counsel.
 - potential or actual conflicts of interests.
 - prior fiduciary administration particularly successor trustee accounts.
 - Cotrustee relationships.
4. Select a sample of successor trustee accounts, evaluate the bank's review of prior fiduciary administration of the trusts. For each selected account determine

- whether the prior trustee properly resigned or was removed in a legally acceptable manner.
 - whether the trust document or state law provides the bank with protection from acts of the predecessor trustee. Consider the use of waivers and exculpatory language in the governing instrument. If not, has the bank determined whether
 - the prior fiduciary fully accounted for its actions?
 - the prior fiduciary provided adequate accountings to the appropriate parties and been fully released?
 - such release extends to the successor trustee?
 - whether the bank obtained prior fiduciary tax records and reviewed them for consistency with current statements, accountings, and asset inventories. If discrepancies were identified, did the bank take appropriate action?
5. Select a sample of personal fiduciary accounts for review. Evaluate the adequacy and effectiveness of the following:
- Checklists or other methods used to ensure that all the necessary documentation is obtained for the account. Are original or authenticated copies of the governing instrument obtained and adequately secured, including court orders and inventories?
 - Receipts, inventories, and appraisals for court-supervised accounts, or schedules of assets delivered to the bank or the bank's control for custody and protection.
 - Administrative files that contain
 - synoptic data that should summarize the governing instrument provisions, including investment and retention powers, income remittances, dispositive provisions, corpus invasions, and other important authorizations (records of names of parties-in-interest, co-fiduciaries, and other relevant historical data should be part of this information).
 - legal documents.
 - correspondence.
 - account reviews.
 - investment transactions.
 - tax documents and reports.
 - regulatory filings.
 - Tickler files or other tracking methods relating to the preparation and timely execution of future duties such as account reviews, income remittances, principal distributions, insurance and tax deadlines, fee and statement information, and termination events.
6. Evaluate the initial post-acceptance review for each selected account. Determine whether the review includes
- review of the governing instrument and a determination of its purpose, intent, investment guidelines, and powers.

- review of all discretionary assets to determine whether they are appropriate for the account as required by 12 CFR 9.6(b) for national banks and 12 CFR 150.210 for FSAs.
- determination of compliance with internal policies and procedures.
- approval of an appropriate investment policy statement.

Objective: To determine the quality of account administration processes.

1. Select an appropriate sample of established personal fiduciary accounts. A sufficient number of accounts should be selected to form a reliable assessment of the bank's processes. Account selection may be based on risk factors such as size, complexity, litigation, and insider relationships, but the sample must be of sufficient size to satisfy the examination's objectives.
2. Review each selected account and determine whether administrative processes are adequate and effective.⁷ Determine whether
 - account's activity complies with the terms of the governing instrument and meets the needs of account beneficiaries according to their circumstances.
 - account's activity complies with federal, state, and local laws and court orders and directions.
 - bank performs annual account reviews in accordance with 12 CFR 9.6(c) for national banks, 12 CFR 150.220 for FSAs, and other applicable law.
 - bank conducts an administrative review of the account and whether the frequency and scope of these reviews are consistent with bank procedures.
 - bank follows its procedures, relevant documentation, and the terms of the instrument when it conducts transactions in the account.
 - Based on a review of transaction activity, are investment and distribution directions coming from authorized parties and in proper form?
 - Are wire transactions authenticated and, for investment management accounts, following Regulation E if foreign? (The "Electronic Fund Transfer Act" booklet of the *Comptroller's Handbook* details applicable Regulation E requirements.)
 - bank prepares and provides accurate account statements and required court accountings.
 - bank prepares and files accurate income, inheritance, gift and estate tax filings, and returns.
 - bank avoids conflicts of interest and self-dealing.
 - bank charges and reports accurate account fees and complies with the "reasonable compensation" provisions of 12 CFR 9.15 for national banks and 12 CFR 150.380 for FSAs.

⁷ The "Conflicts of Interest," "Investment Management Services," and "Unique and Hard-to-Value Assets" booklets of the *Comptroller's Handbook* include detailed examination procedures covering a broad variety of asset and investment strategies. Refer to these booklets for additional examination procedures that specifically focus on conflicts, concentrations, investment management, specialty assets, acceptance of or investment in non-approved assets, treatment of non-performing assets, required committee approvals, etc.

- any services provided by a third-party vendor are properly performed, the vendor's charges are appropriate and reasonable, and the arrangements are consistent with OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."
3. Determine whether fiduciary managers and administrators have an adequate knowledge and understanding of the accounts assigned to them:
 - Are fiduciary accounts assigned to a specific administrator?
 - Are fiduciary managers aware of account problems, such as litigation, complaints, and other important administrative matters?
 - Have account administrators maintained account files in accordance with policy and sound administrative practices?
 4. Evaluate the bank's process for administering directed or bifurcated trust accounts in which the bank was not provided investment management responsibilities.
 - Determine whether the bank has obtained legal guidance that defines what its responsibilities are as a directed or excluded trustee.
 - Determine whether the bank has potentially assumed additional liability by engaging in investment reviews that exceed the scope of the bank's authority.
 5. Evaluate the bank's processes for administering cotrustee accounts.
 - Determine whether proper and timely written authorizations are obtained from co-fiduciaries or others whose approval may be required for important actions.
 - Determine the effectiveness of the process of obtaining and following up on co-fiduciary and grantor approvals.
 6. Evaluate the bank's account cash management processes.
 - Identify and review large uninvested or undistributed cash balances and discuss them with management. Determine whether administration of the particular accounts is appropriate and complies with 12 CFR 9.10 for national banks and 12 CFR 150.290 through 12 CFR 300 for FSAs ("Fiduciary funds awaiting investment or distribution").
 - Review account overdrafts, giving attention to large and longstanding items. Determine why they exist and discuss management's plans to clear them.
 - Determine whether there are appropriate policies and procedures that address the handling and clearing of cash management and overdraft situations.
 7. Evaluate the bank's discretionary distribution processes.
 - Is the decision-making authority for discretionary distributions expressly defined and communicated to all personnel?
 - Are decisions fully documented and authorized by designated personnel or committees?

- Are distributions consistent with the guidelines established in the governing instrument? Consider the following:
 - Language in the governing instrument
 - Intent of the grantor
 - Need for the payment and the purpose for which it will be used
 - Needs of other beneficiaries
 - Size and duration of the fiduciary account
 - Number, ages, and standard of living of the beneficiaries
 - Other assets or sources of income available to the beneficiary
 - Tax consequences of a distribution

8. Evaluate the bank's record-keeping and client reporting processes.

- Is account income properly received and recorded? Does the bank properly allocate cash and other receipts to principal and income in accordance with the governing instrument or state law?
- Do disbursements and expenditures comply with the governing instrument, other applicable law, and internal policy?
- Are account fees and other charges appropriate, accurate, and consistent with applicable law?
- Does the bank have an account statement distribution policy and supporting procedures? Is the bank complying with the policy?
- Are statements prepared and distributed to persons entitled to them?
- Are statements distributed to persons who are not entitled to them?
- Are distributions in line with original transaction activity anticipated for the account (e.g., BSA/AML purposes)?

9. Review fiduciary tax administration and evaluate the process to prepare and file fiduciary related tax returns.

- Is the amount of estimated quarterly taxes remitted to the IRS and applicable state taxing authorities adequately supported?
- Are estate taxes (federal and state) remitted within the time limits required by the IRS and state taxing authorities?
- Are federal and state tax returns filed on a timely basis?
- Are fair evaluations performed on estate assets?
- Are the effects of the generation-skipping transfer tax considered on distributions to younger generations?

10. Evaluate the bank's process for closing fiduciary accounts.

- Is the process clearly defined with specified approval authority?
- Is a review by legal counsel part of the process?
- Are appropriate allocations of income determined at the time of closing?
- Is the fee unit notified when an account is terminated?

- Are estate and federal income tax issues appropriately considered?
- Is an adequate plan of distribution created?
- Are signed receipts of assets obtained when assets are distributed?
- Are judicial accountings appropriately administered?

Objective: To determine the adequacy and effectiveness of internal control within the personal fiduciary area.

1. As appropriate and approved by the bank EIC and examiner responsible for evaluating internal control, select and complete appropriate internal control examination procedures from the “Internal Control” booklet of the *Comptroller’s Handbook*.
2. After completing the examination procedures in the item above and reviewing the results of the control systems examination procedures, draw conclusions on internal control for personal fiduciary activities.
3. Submit the assessment of internal control to the examiner responsible for evaluating internal control for asset management activities.

Objective: To determine the adequacy and effectiveness of third-party vendor selection and monitoring processes.

1. Review policies and procedures for the selection and monitoring of third-party vendors. Discuss the process with management and document weaknesses in risk management processes. Consider the following:
 - Quality of the due diligence review process.
 - Contract negotiation and approval process.
 - Risk assessment processes.
 - Risk management and audit division participation.
 - Vendor monitoring processes, such as the assignment of responsibility, the frequency of reviews, and the quality of information reports reviewed.
 - Vendor problem resolution process.
 - Adherence to OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance.”
2. Obtain a list of vendors the bank uses or has used to provide fiduciary activities and support. Select a sample from the vendor list and evaluate the adequacy and effectiveness of the bank’s selection and monitoring processes for each vendor selected.

Objective: To determine the adequacy and effectiveness of processes used to develop and approve new personal fiduciary products, services, or lines of business.

1. Evaluate how management plans for and develops new products and services. Consider the following:

- Types of market research conducted, such as product feasibility studies.
 - Cost, pricing, and profitability analyses.
 - Risk assessment processes.
 - Legal counsel and review.
 - Role of risk management and audit functions.
 - Information systems and technology impact.
 - Human resource requirements.
2. Evaluate the product approval process by selecting a sample of products or services developed and rolled out since the last examination of this area:
- Is the approval authority clearly established and adhered to?
 - Were bank policies and procedures adequately followed?
 - Does the process require adequate documentation of the factors considered and adequate support for the final decision?

Personnel

Personnel are the bank staff and managers who execute or oversee processes. Personnel should be qualified and competent and should perform appropriately. They should understand the bank’s mission, values, principles, policies, and processes. Banks should design compensation programs to attract, develop, and retain qualified personnel. In addition, compensation programs should be structured in a manner that encourages strong risk management practices.

Objective: To determine management’s ability to supervise personal fiduciary activities in a safe and sound manner.

1. Given the scope and complexity of the bank’s personal fiduciary activities, assess the management structure and staffing. Consider the following:
 - Expertise, training, and number of staff members.
 - Whether reporting lines encourage open communication and limit the chances of conflicts of interest.
 - Level of staff turnover.
 - Use of outsourcing arrangements.
 - Capability to address identified deficiencies.
 - Responsiveness to regulatory, accounting, industry, and technological changes.
2. Assess performance management and compensation programs. Consider whether these programs measure and reward performance that aligns with the bank’s strategic objectives and risk tolerance.
3. If the bank offers incentive compensation programs, determine whether the programs are consistent with OCC Bulletin 2010-24, “Incentive Compensation: Interagency Guidance

on Sound Incentive Compensation Policies,” including compliance with its three key principles: (1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance, including active and effective oversight by the bank’s board of directors.

4. If the bank has third-party relationships that involve critical activities, determine whether oversight is consistent with OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance.”

Objective: To determine the quality of personal fiduciary management and supporting personnel.

1. Obtain a list of personal fiduciary management and key supporting personnel that includes the following information:
 - Title and job responsibilities.
 - Formal education and training.
 - Related work experience and accomplishments.
 - Reporting lines and organizational structure.

Fiduciary management includes any bank director, fiduciary committee member, fiduciary manager, account administrator, third-party vendor, or other bank employee responsible for developing, approving, or implementing personal fiduciary business strategies, policies, and information systems.

2. Review fiduciary management and supporting personnel and determine whether management is
 - competent based on the complexity of the bank’s personal fiduciary lines of business.
 - knowledgeable of fiduciary policies, strategic plans, and risk tolerance standards.
 - aware of the bank’s code of ethics, if applicable, and committed to high ethical standards.
3. Evaluate the adequacy of staffing levels by reviewing and discussing the following:
 - Current strategic initiatives and financial goals.
 - Current business volume, complexity, and risk profile.
 - Recent staffing analyses and recommendations.
 - The impact of company cost-cutting programs, if applicable.
4. Compare job descriptions and other responsibilities of managers and key supporting personnel with their experience, education, and other training.
 - Are personnel qualified and adequately trained for positions and responsibilities?
 - Does the number of clients or accounts assigned to administrators appear reasonable?

- Are personnel performing tasks outside their job descriptions that adversely affect their overall performance or risk levels?

Objective: To determine the adequacy and effectiveness of the bank's personnel policies, practices, and programs.

1. Determine whether lines of authority and individual duties and responsibilities are clearly defined and communicated.
2. Evaluate the bank's recruitment and employee retention program by reviewing the following:
 - Recent success in hiring and retaining high-quality personnel.
 - Level and trends of staff turnover, particularly in key positions.
 - The quality and reasonableness of management succession plans.
3. Analyze the bank's compensation and performance evaluation program.
 - Is the program formalized and periodically reviewed by the board and senior management?
 - Is the program consistent with the bank's risk tolerance and ethical standards?
 - Are responsibilities and accountability standards clearly established for the performance evaluation program?
 - Is the program applied consistently and functioning as intended?
 - Does the program reward behavior and performance that is consistent with the bank's ethical culture, risk tolerance standards, and strategic initiatives?
 - Does the program include an adequate mechanism for the board to evaluate management performance?
4. Review the training program by considering the following:
 - The types and frequency of training and whether the program is adequate and effective.
 - How much of the fiduciary budget is allocated to training and whether the financial resources applied are adequate.
 - Whether employee training needs and accomplishments are a component of the performance evaluation program.

Control Systems

Control systems are the functions (such as internal and external audits, risk review, and quality assurance) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Control functions should have clear reporting lines, adequate resources, and appropriate authority. MIS should provide timely, accurate, and relevant feedback.

Objective: To determine whether the bank has systems in place to provide accurate and timely assessments of the risks associated with its personal fiduciary activities.

1. Evaluate the effectiveness of monitoring systems to identify, measure, and track exceptions to policies and established limits.
2. Determine whether MIS provides timely, accurate, and relevant information to evaluate risk levels and trends in the bank's personal fiduciary activities.
3. Assess the scope, frequency, effectiveness, and independence of the internal and external audits of personal fiduciary activities.
4. Assess the effectiveness of other independent risk control functions in personal fiduciary activities.

Objective: To determine the quality of board and management risk controls and monitoring systems.

1. Determine and evaluate the types of fiduciary risk control and monitoring systems used by the board and management. Consider the following:
 - Board and senior management fiduciary information reports
 - Personal fiduciary risk management groups
 - Personal fiduciary committee structures, responsibilities, and performance
 - MIS
 - Compliance programs
 - Control self-assessments
 - Audit program
2. Determine the extent to which the board and senior management are involved in personal fiduciary activity risk control and monitoring. Consider the following:
 - Types and frequency of board and senior management personal fiduciary reviews used to determine adherence to policies, operating procedures, and strategic initiatives.
 - Accuracy, timeliness, relevance, and distribution of management information reports.
 - Responsiveness to risk control deficiencies and the effectiveness of corrective action and follow-up activities.
 - Frequency, content, and usefulness of litigation reports.
 - Responsiveness to internal and external audits and regulatory examinations.
3. If applicable, evaluate the compliance program. Consider the following:
 - Strength of board and senior management commitment and support.
 - Line management responsibility and accountability.

- Program formalization, transaction testing, reporting structures, and follow-up processes.
 - Qualifications and performance of compliance officer and supporting personnel.
 - Communication systems.
 - Training programs.
4. If the bank has implemented a control self-assessment program, obtain information on its assessment of controls in the personal fiduciary activities area. Evaluate the program and the results of recent control self-assessments of business and support functions.
5. Review the bank’s audit activity relating to personal fiduciary activities. A key goal of this review is to determine how reliable the internal and external audit work is. In the course of the review,
- select and complete appropriate examination procedures from the “Internal and External Audits” booklet of the *Comptroller’s Handbook*. Coordinate the selection of procedures with the examiner responsible for evaluating the bank’s audit program.
 - obtain appropriate internal audit reports, work papers, and follow-up reports. Disseminate the reports to the appropriate examiners for review and follow-up.
 - determine the adequacy and effectiveness of the internal audit program by reviewing
 - timing, scope, and results of audit activity.
 - quality of audit reports, work papers, and follow-up processes.
 - independence, qualifications, and competence of audit staff.
 - If the review of audit reports and work papers raises questions about audit effectiveness, discuss the issues with appropriate examiners and determine whether the scope of the audit review should be expanded. Issues that might require an expanded scope include the following:
 - Unexplained or unexpected changes in auditors or significant changes in the audit program.
 - Inadequate scope of the audit program.
 - Audit work papers that are deficient or do not support audit conclusions.
 - High-growth areas without adequate audit coverage.
 - Inappropriate actions by insiders to influence the findings or scope of audits.
6. Draw conclusions about the adequacy and effectiveness of the audit program and forward the findings and recommendations, if applicable, to the examiner responsible for evaluating the bank’s audit program.

Conclusions

Conclusion: The aggregate level of each associated risk is
 (low, moderate, or high).
 The direction of each associated risk is
 (increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of personal fiduciary activities.

1. Determine preliminary examination findings and conclusions and discuss with the EIC, including
 - quantity of associated risks (as noted in the “Introduction” section of this booklet).
 - quality of risk management.
 - aggregate level and direction of associated risks.
 - overall risk in personal fiduciary activities.
 - violations and other concerns.

Summary of Risks Associated With Personal Fiduciary Activities				
Risk category	Quantity of risk (Low, moderate, high)	Quality of risk management (Weak, satisfactory, strong)	Aggregate level of risk (Low, moderate, high)	Direction of risk (Increasing, stable, decreasing)
Operational				
Compliance				
Strategic				
Reputation				

2. Discuss examination findings with the asset management EIC and adjust findings and recommendations as needed. Contact the supervisory office before the exit meeting with management if the personal fiduciary activities area exhibits significant weaknesses or concerns, such as the following:
 - Area is less than satisfactory.
 - Bank’s policies, procedures, or controls have not proven effective and require strengthening.
 - Uniform Interagency Trust Rating System (UITRS) compliance assessment shows significant weaknesses.
 - Exam findings are likely to contribute to a UITRS composite rating of 3 or worse.
 - Level of risk is moderate and increasing because of personal fiduciary activities.

- Level of any risk is high because of fiduciary activities.
3. Discuss examination findings with bank management, including violations, recommendations, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.
 4. Compose conclusion comments, highlighting any issues that should be included in the report of examination. If necessary, compose a matters requiring attention comment.
 5. Update the OCC's information system and any applicable report of examination schedules or tables.
 6. Write a memorandum specifically setting out what the OCC should do in the future to effectively supervise personal fiduciary activities in the bank, including time periods, staffing, and workdays required.
 7. Update, organize, and reference work papers in accordance with OCC policy.
 8. Ensure any paper or electronic media that contain sensitive bank or customer information are appropriately disposed or secured.

Appendixes

Appendix A: Types of Personal Trusts

This section provides general information on various types of personal trusts. Bank fiduciaries should consult with appropriate legal and tax counsel for comprehensive guidance on the proper use and ramifications of these types of trust instruments.

Grantor Trusts

A grantor is a person who transfers property by deed or who grants property rights by means of a trust instrument or some other document. A grantor trust is a living trust in which the grantor, because of certain rights to income or principal or certain power over the disposition of income and principal, is treated as the owner of the trust and taxed on its income. A grantor trust is not treated as a separate entity for income tax purposes.

A grantor trust may be revocable or irrevocable depending on the planning needs of the grantor. This type of trust provides many lifetime advantages to the grantor. The grantor retains control over the trust's assets during his or her lifetime. In addition, assets owned by the trust will be held or distributed at the death of the grantor in accordance with the trust agreement and will not be subject to probate administration.

Declaration of Trust

A declaration of trust is a basic grantor trust used when the grantor wants to have the trust operational and have full control. The grantor declares him or herself to be trustee of certain identified assets and serves as the initial trustee.

Grantor Retained Annuity Trust

A grantor retained annuity trust (GRAT) is an irrevocable trust in which the grantor retains the right to a set annual dollar amount (the annuity) for a fixed term and gives the principal to others, such as the grantor's children, at the end of that term. If the grantor survives until the end of the annuity term, all of the trust principal is excluded from the grantor's estate for estate tax purposes.

Because this is a lifetime transfer into an irrevocable trust, the gift must be valued for gift tax purposes using IRS rules. The favorable tax consequences on the value of the gift allow the grantor and the beneficiaries to benefit from any increase in the value of the gift without paying estate taxes.

Grantor Retained Income Trust

In a grantor retained income trust (GRIT), the grantor retains the right to receive all of the trust's income for a fixed term and gives the principal to others, such as the grantor's

children, at the end of that term. If the grantor survives until the end of the income term, all principal will be excluded from the grantor's estate for tax purposes. In most cases, a transfer to a GRIT will be treated as an outright gift to the remaindermen.

Grantor Retained Unitrust Trust

A grantor retained unitrust trust (GRUT) is identical to a GRAT in every way except that the income interest retained by the grantor is a unitrust interest. Each year the trustee calculates the amount of the interest payment as a percentage of the market value of the trust property. This type of trust is particularly useful if the grantor intends to add assets to the trust.

Standby Trust

A standby trust, or “pour over” trust, is so named because one of its purposes is to receive the grantor's assets upon his or her death. Some jurisdictions require that these trusts be funded with a nominal amount of trust property in order to be effective; others do not. By creating one of these trusts, assets owned by the grantor at death can “pour over” into the trust. This trust has two major benefits:

- Funds can be quickly transferred to the trust, if necessary.
- Property may also be transferred to the trust under the residuary clause of the testator's will. The grantor obtains additional privacy because terms of a standby trust are not made public, unlike the terms of a testamentary trust.

Crummey Trust

A “Crummey trust” is named after a court decision (*Crummey v. Commissioner of IRS*, 397 F.2d 82 (1968)) that upheld a taxpayer's arrangement in which annual tax-free gifts (typically from a parent to a child) could be aggregated to, over time, form a substantial trust. Beneficiaries of a trust with Crummey powers are granted limited power to withdraw property that is earned or contributed to the trust. This power is set for a limited amount of time in the trust agreement. By providing the beneficiary of the trust the right to immediate possession of each gift, the transfers to the trust qualify for the annual gift tax exclusion (\$14,000 per individual, \$28,000 per married couple as of 2015). The Crummey power is an especially useful way to make gifts to minors, because distribution of the trust's assets is not required when the minor attains age 21.

To take advantage of the federal gift tax exclusion, a donor must make a gift of a present interest to the trust. While a recent tax court opinion (*Estate of Turner v. Commissioner of IRS*, T.C. Memo. 2011-209 (2011)) appears to have relaxed certain of the criteria established in the Crummey case, a best practice is still to provide the beneficiaries of a gift the power to withdraw the contributed property outright. If the beneficiaries decline to withdraw the contributed property from the trust, the property is available to satisfy the primary purpose of the trust. While the previous requirement that beneficiaries receive actual, timely notice of their withdrawal rights before the lapse of such rights may no longer be a legal requirement, it remains a best practice and a bank should consult with counsel if they are not providing

withdrawal rights notices in these situations. While this strategy may be used to accumulate annual gifts for individual beneficiaries using any investment device, insurance contracts—in which the insurance contract’s premium is paid with an annual gift—historically have been the most prevalent and provide the most certainty.

Special Needs Trust

There are two principal forms of a special needs trust: (1) a first-party or self-settled special needs trust, and (2) a third-party special needs trust. A first-party special needs trust is funded with the property of the person with special needs. This property may be acquired as an inheritance, from an insurance policy, or from a personal injury award. By removing these assets from their own name and putting these assets in a trust, the special needs individual may be able to avoid jeopardizing their eligibility for government benefits such as Medicaid and Social Security disability. To avoid sheltering the assets of a special needs beneficiary solely to qualify for government benefits, however, there are specific state and federal requirements that must be met and there are payback requirements that apply to first-party special needs trusts. Distributions for the benefit of the beneficiary are generally quite restrictive. Upon the death of the special needs beneficiary, the remaining trust assets generally must be used to repay the state’s Medicaid program for expenses it incurred on behalf of the beneficiary.

A third-party special needs trust is usually funded for the benefit of a special needs relative with assets from family members, rather than with the assets of the beneficiary. In many instances, funding occurs upon the death of a parent or another care provider of the special needs beneficiary. As with first-party special needs trusts, to preserve eligibility for government benefits, trust assets must be controlled by the trustee and may only be used to purchase certain items for the special needs beneficiary.

Life Insurance Trust

A life insurance trust, or “wealth replacement trust,” is typically used for estate planning, business continuation, or liquidity needs upon the grantor’s death. In addition, one of the objectives of a life insurance trust is to move assets out of the grantor’s estate. By contrast, the proceeds of traditional life insurance policies outside of a trust are generally subject to estate tax in the estate of the owner of the policy. For a more detailed discussion of issues associated with life insurance trusts, refer to the “Unique and Hard-to-Value Assets” booklet of the *Comptroller’s Handbook*.

Revocable life insurance trust. Like a standby trust, a revocable life insurance trust is funded with a nominal amount of trust property during the grantor’s lifetime. The trust is designated as the recipient of life insurance proceeds upon the grantor’s death, and the trust becomes fully funded with the insurance proceeds. This arrangement is used when the grantor does not have significant assets to be managed during his or her lifetime but has significant insurance benefits that need to be managed upon the grantor’s death.

Irrevocable life insurance trust. Life insurance can be purchased by, or assigned to, an irrevocable trust to shelter insurance proceeds from the estate tax that would be imposed if the owner of the policy died while owning it. The life insurance policy is usually the sole asset of the trust while the insured is alive. The trust is generally the beneficiary of the insurance policy and holds title to the insurance policy during the life of the insured. The grantor is allowed to make gifts of present interest to the trust for the purpose of purchasing life insurance. The grantor may either pay the premiums for the policy or forward the money to the trustee for payment of the premiums. The trust usually includes Crummey powers that give trust beneficiaries current withdrawal rights over amounts transferred to the trust so that these transfers qualify for the annual gift tax exclusion.

Upon the death of the insured, the trustee follows the terms of the trust concerning the use of the insurance policy proceeds. Some insurance trusts are funded with other assets for the trustee to manage and to use those assets to pay the life insurance policy premiums. For more information on the uses and risks associated with irrevocable life insurance trusts, refer to the “Unique and Hard-to-Value Assets” booklet of the *Comptroller’s Handbook*.

One of the trustee’s responsibilities is to ensure that the trust’s tax benefits are preserved. The bank should have controls to ensure that the following requirements are met:

- The trust agreement must include Crummey powers. A best practice is for the trustee to inform the beneficiaries of their right to withdraw principal from the trust. Documentation should be maintained to establish that these notices were sent to all beneficiaries, or that counsel expressly advised the bank such notices are not required under the Internal Revenue Code.
- The insured must not hold at death, and must not have held in the previous three years, any incident of ownership in the insurance policy. The trustee must have total control of the policy if the proceeds are to be withheld from the insured’s estate.
- The proceeds of the life insurance policy may not be paid to the estate of the insured, nor can they be used in a manner that directly benefits the estate. Although the trust is intended to benefit the estate indirectly, the trustee cannot be under any obligation to pay the insured’s estate taxes. If such payments are made, the entire amount of the insurance proceeds must be included in the insured’s estate.

Marital Deduction Trusts

A marital deduction trust is used to transfer a decedent’s property into trust and take advantage of the unlimited marital deduction. Transfers of property to a marital deduction trust are designed to be exempt from federal gift and estate taxes. Many states provide the same marital deductions as the federal tax laws. The grantor may choose among various types of marital deduction trusts.

General Power of Appointment

A marital deduction trust with a general power of appointment gives the surviving spouse beneficiary maximum control of the trust property during his or her life. The spouse may

withdraw part or all of the trust property and may exercise a general power of appointment over the trust property during life and/or at death. In 2014, trust assets in excess of \$5.34 million (\$10.68 million for most married couples) were subject to federal estate tax upon the death of the surviving spouse. In addition, many states also levy estate taxes; some match the federal estate tax exemption, other states have significantly lower exemptions.

Qualified Terminable Interest Property Trust

A qualified terminable interest property (QTIP) trust is used to provide a surviving spouse financial support and retain control over the distribution of the trust's assets when the lifetime beneficiary spouse dies. A QTIP trust allows a grantor to ensure that his or her assets ultimately pass to chosen beneficiaries. The executor may be given power to elect none, some, or all of the trust property for the marital deduction. The executor makes the QTIP election when the first spouse dies.

To qualify for the unlimited marital deduction, the trustee must ensure that the following criteria are met:

- All income must be paid at least annually to the spouse.
- No person, including the spouse, has the right to transfer property held in a QTIP trust to anyone other than the spouse during the spouse's life.
- The spouse has the authority to demand that any non-income producing property be converted to income-producing property.

Estate Trust

An estate trust pays income to a surviving spouse or accumulates all of its income. Upon the surviving spouse's death, trust assets must be distributed to the surviving spouse's probate estate. Estate trusts are rarely used marital deduction trusts but do qualify for the marital deduction and are treated as a separate taxpayer for income tax purposes.

Qualified Domestic Trust

A qualified domestic trust is a federal marital deduction trust for the benefit of a spouse who is not a U.S. citizen and therefore is not eligible for the unlimited marital deduction available to a U.S. citizen when a spouse dies. The purpose of this trust is to qualify assets left to a nonresident, noncitizen spouse for the marital deduction. This type of trust is similar to a QTIP but has additional restrictions.

Credit Shelter Trusts

A credit shelter trust, also called a bypass or family trust, is designed to take advantage of a U.S. taxpayer's unified credit against the federal gift or estate tax. Many states have similar credits. Typically, an individual creates a credit shelter trust in the amount of the unified credit established in the tax code, and property placed in the trust is not included in the decedent's estate for tax purposes. The decedent's surviving spouse is typically the trust

income beneficiary, and the trust normally terminates on the death of the surviving spouse. Remaining trust property passes to the remaindermen free of estate tax.

This trust is usually designed to pass family wealth to the grantor's descendants while making the property available to the surviving spouse during his or her lifetime. Both income and principal may be distributed to the spouse or other individuals during the term of the trust. Credit shelter trusts can be created during the grantor's lifetime, although these trusts are more typically created by will as part of a testamentary estate plan.

Generation-Skipping Trust

The generation-skipping transfer tax (GSTT) is a flat tax on any transfer to a grandchild or any person two or more generations removed from the donor. Each U.S. taxpayer has a specific dollar exemption from this tax (\$5.34 million in 2014). A generation-skipping trust (GST) takes advantage of this exemption by transferring property up to the exemption amount to a trust for the benefit of trust beneficiaries who are two or more generations beyond or below the grantor. If structured properly, GST property can pass to future generations without payment of the GSTT. A grantor may have reasons other than avoiding the transfer tax for establishing the trust.

A GST typically benefits the grantor's grandchildren, who may be present, future, or contingent beneficiaries. For example, a GST may be established to benefit the grantor's children and grandchildren during their lifetimes, with trust property distributing outright to grandchildren on the children's death. Alternatively, a GST may continue for the longest term allowed by state law, many of which (as previously discussed) are governed by the rule against perpetuities. The grantor may allocate his or her generation-skipping tax exemption to the amounts contributed to the trust. The tax goal of the GST is to avoid estate tax at the death of the grantor's children.

Even with the enactment of the American Taxpayer Relief Act of 2012 and the permanent increase in the gift and estate tax exemption in 2014 to \$5.34 million (indexed for inflation), grantors continue to seek to avoid both quantifiable and potential future estate taxes. In order to close a loophole in the estate and gift tax provisions, the tax code imposes the GSTT. The GSTT is intended to capture transfers made by a donor to beneficiaries two or more generations above or below the donor ("skip persons"), such as grandchildren. An exemption to the GSTT allows \$5.34 million to pass untaxed from each donor to each skip person.

Dynasty trusts are commonly created using permissive laws enacted in various states to utilize the grantor's and the grantor's spouse's GSTT exemptions. Dynasty trusts are specialized irrevocable trusts designed to shelter assets from transfer taxes over multiple generations of the grantor's family. By virtue of the extensive term of the trust, the trust property and its future appreciation can be sheltered from estate taxation beyond multiple generations of deaths in a family.

Minor Exclusion Trust

A minor exclusion trust, or 2503(c) trust, is established for the benefit of a minor and is designed to qualify for the annual gift tax exclusion of the grantor and exemption from the GSTT. The trust can last until the minor reaches the age of 21. The trust must provide that the principal and income can be used for the benefit of the minor beneficiary before he or she attains 21 years of age. Any property remaining in the trust must be transferred to the beneficiary when the beneficiary turns 21. The trust can be structured so that it continues after the beneficiary reaches 21 so long as the beneficiary has the option to demand a distribution at 21.

The establishment of a 2503(c) trust creates a separate taxable entity for both income and estate tax purposes. As a trust, it differs from the agency arrangements established under the Uniform Gift to Minors Act or the Uniform Transfers to Minors Act and is designed to ensure separation of the trust assets from the grantor's taxable estate.

Charitable Trusts and Donor-Advised Funds

A charitable trust is a trust created for the benefit of an IRS approved charity. There are two types of charitable trusts: charitable remainder (CRT) and charitable lead trusts (CLT). A donor-advised fund is another vehicle to make tax-advantaged donations to charitable institutions.

Charitable Remainder Trust

A CRT is an irrevocable trust established for the life of the donor or other non-charitable life beneficiaries with the remainder payable to a charity at the death of the life beneficiaries. The CRT may be either an inter vivos or a testamentary trust. The grantor may choose to retain the income from the CRT during his or her life, or the grantor may divert the income to another beneficiary.

A CRT is also called a split interest trust because the income interest and remainder interest go to different parties. This type of trust has two purposes: (1) it pays any income or annuity interest earned by the trust assets to the income beneficiaries, and (2) it transfers the trust's assets to a charity upon the death of the beneficiaries or at the end of the trust term. While the income payout period for this arrangement generally may not exceed 20 years, a term based on the life expectancy of the income beneficiaries may exceed the 20-year limit.

This type of trust is attractive to people whose assets have a low-cost basis and produce little income. (For example, real estate holdings or securities owned for many years.) A CRT allows the donor to realize an immediate income tax deduction. The deduction is computed using IRS actuarial tables to determine the value of the remainder interest going to the charity. The older the donor is, the greater the deduction. The donor also avoids what may be substantial capital gains taxes on the sale of the donated property by the trustee. The governing instrument must be specific to ensure that the charitable deduction is realized. The following types of CRTs differ in how they calculate payments to beneficiaries:

- **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.

Appendix B: Uniform Trust Laws

“Model” or “uniform” acts are promulgated by legal and trade groups to standardize state laws. State legislatures may adopt these model laws as drafted or modify them to meet the needs of their particular states. Examples of uniform laws adopted by the Uniform Law Commission (the National Conference of Commissioners on Uniform State Laws) in the personal fiduciary area include the following:

- Uniform Common Trust Fund Act
- Uniform Custodial Trust Act
- Uniform Disclaimer of Property Interests Act
- Uniform Disposition of Community Property Rights at Death Act
- Uniform Estate Tax Apportionment and Probate Code
- Uniform Fiduciaries Act
- Uniform Health Care Decisions Act
- Uniform Management of Institutional Funds Act
- Uniform Marital Property Act
- Uniform Nonprobate Transfers on Death Act
- Uniform Powers of Appointment Act
- Uniform Premarital and Marital Agreements Act
- Uniform Principal and Income Act
- Uniform Probate Code
- Uniform Prudent Investor Act
- Uniform Real Property Transfer on Death Act
- Uniform Simultaneous Death Act
- Uniform Statutory Rule Against Perpetuities Act
- Uniform Supervision of Trustees for Charitable Purposes
- Uniform Testamentary Additions to Trusts Act
- Uniform Trust Code
- Uniform Trustees’ Power Act

Appendix C: Personal Account Review Worksheet

This worksheet is intended as a job aid. The worksheet is provided to assist examiners in reviewing personal fiduciary activities. The successful completion of this worksheet does not constitute an assessment of risk management or oversight. N/A means not applicable.

Personal Account Review Worksheet

Personal Account Review		
Bank name	Examination date	Examiner initials
Account administrator	Account name	Account number
Account type	Capacity	Current market value
Investment officer	Investment authority	Last Reg. 9 review date
Document date	Date account opened	

Account Synopsis			
Successor		Spendthrift	
Revocable		Irrevocable	
Investment Authority			
Sole		Directed	Shared/cotrustee
State trust statue		Broad powers	Unusual provisions
General retention authority		Specific retention authority	Silent re: retention
Distributions			
Income		Monthly	Quarterly
		Semiannually	Annually
To whom:			
Principal		Monthly	Quarterly
		Semiannually	Annually
To whom:			
Requested		Required	Bill payer
Termination			
Date		Remainderman	

Administrative Matters				
Y	N	N/A		Date (if applicable)
			Governing instruments executed by appropriate parties are on file.	
			Pre-acceptance review was properly performed.	
			New account properly approved.	
			Customer due diligence (enhanced due diligence/customer identification program) properly completed.	
			OFAC screening and AML monitoring done.	
			Distributions during exam period were allowable under the document.	
			Discretionary distributions during exam period were properly supported, with needs assessment, if required.	
			Crummey notices were sent both where and when required.	
			Fees are reasonable, conform to published fee schedules and/or amount stated in document.	
			Account coding is correct.	
			Proxy voting is handled properly.	
			Shareholders Communication Act disclosure was made; account is properly coded objecting beneficial owners/non-objecting beneficial owners (OBO/NOBO).	
			Statements are provided to appropriate parties.	
			Tax filings are done, and done timely (1099, IRS Letter).	
			Administrative reviews are done per bank policy.	
			Appropriate ticklers have been established.	

Conflicts of Interest				
Y	N	N/A		Date (if applicable)
			Account does not hold own bank/bank holding company stock.	
			Proprietary mutual fund holdings properly supported; fees rebated for managed accounts.	
			For third-party funds, 12b-1 or shareholder servicing fees are properly disclosed/authorized.	
			Account does not hold own bank/affiliate bonds, mortgages, or other products.	
			Use of own bank/affiliate money market deposit account is proper.	
			Any use of affiliated broker/dealer is properly authorized.	
			Any use of affiliated insurance affiliate is properly authorized.	
			There are no sales of assets/loans between accounts.	
			There are no loans/sales/dealings with bank officers, directors or employees.	

Investment Matters					
Stated Investment Objective					
Actual			Objective		
	\$000s	%		\$000s	%
			Cash equivalents		
			Equities		
			Fixed income		
			Total		

Special Assets (List name, market value, date and source of valuation)				
Y	N	N/A		Date (if applicable)
			Actual asset allocation agrees with objective.	
			Assets conform to governing instrument and are otherwise suitable.	
			All assets are income producing.	
			All assets have been recently priced; i.e., no assets have stale prices.	
			Holdings are on an approved list, meet bond quality standards, etc.	
			There are no concentrations exceeding 10% of the account's market value.	
			The level of cash/liquid assets is reasonable (no overdrafts or excess).	
			Excessive trading has been avoided.	
			Written directions/approvals have been obtained where necessary.	

Special Assets				
Y	N	N/A		Date (if applicable)
Closely Held Securities				
			Proper valuations are on file.	
			A recommendation either to sell or retain the asset was made.	
Real Estate Assets				
			Environmental inspection completed before account acceptance.	
			Valuation appropriately supported (triennial appraisal or other approved method).	
			Appropriate insurance is in place; property taxes are paid.	
			Income producing real estate is leased at a market rate.	
			Mineral interests are properly valued and managed.	
			Real estate or other notes are current and collateral is adequate.	
			Other special assets are properly managed.	

Investment Reviews				
Y	N	N/A		Date (if applicable)
			Initial/annual Reg. 9 review is done timely.	
			Initial/annual Reg. 9 review detected/addressed issues.	
			Special assets are appropriately addressed in the review.	

Other				
Y	N	N/A		Date (if applicable)
			Other issues noted?	

Comments and Exceptions Noted				

Personal Account Review Worksheet

Synopsis Information			
Bank name:		Charter number:	
Examination date:		Examiner:	
Account name:		Grantor:	
Account number:		Cotrustee:	
Account type:		Account officer:	
Revocable?		Portfolio manager:	
Bank's capacity:		Tax ID number, if available:	
New and Successor Accounts			
Date account accepted:		If successor, indemnity in file?	
Account opening sheet used?		Pre-acceptance review date:	
Acceptance noted in minutes?		Customer Identification Program form & OFAC check?	
Executed document on file?		Customer ID determination?	
Investment Authority		Retention Authority	
Prudent investor rule:		General power of retention:	
Grantor directs:		Specific retention provisions:	
		Other (specify):	
Distributions		Termination	
Income distributions?		When?	
Principal distributions?		To whom?	
Discretionary distributions?			
Emergency provisions?		Synopsis Records	
Spendthrift clause?		Is synopsis sheet accurate?	
Assets			
Money market (sweep):		Own bank securities/deposits?	
Fixed income:		If so, proper direction?	
Equities:		Any holdings over 10%?	
Real estate:		If so, diversification plan?	
Miscellaneous:		Mutual funds that pay fees?	
Total:	0%	If so, properly disclosed/approved?	
		Liquidity-overdrafts/excess cash?	
What is investment objective?	% Equity	% Fixed	Special assets?
Do assets conform with investment objective?			If so, adequately administered?
			Excessive trading?
Investment (Reg. 9) Review			
Investment review date:		Include review of assets per Prudent Investor Rule?	
Review noted in minutes:		Did review identify/address issues?	

Distributions			
Were required distributions (i.e., income) made?		Do discretionary distributions conform to document?	
Were distributions properly supported?		Are discretionary distributions properly supported?	
Were principal invasions proper?			

Other Exceptions			
Approvals of cotrustee or others?		Transactions with insiders?	
Fee calculation:		Sales between accounts?	

Comments

Appendix D: Abbreviations

AML	anti-money laundering
BSA	Bank Secrecy Act of 1970
CFR	Code of Federal Regulations
CLT	charitable lead trust
CRT	charitable remainder trust
EIC	examiner-in-charge
FFIEC	Federal Financial Institutions Examination Council
FSA	federal savings association
GRAT	grantor retained annuity trust
GRIT	grantor retained income trust
GRUT	grantor retained unitrust trust
GST	generation-skipping trust
GSTT	generation-skipping transfer tax
IRA	Individual Retirement Account
IRS	Internal Revenue Service
MIS	management information systems
OBO/NOBO	objecting beneficial owner/non-objecting beneficial owner
OCC	Office of the Comptroller of the Currency
OFAC	Office of Foreign Assets Control
QTIP	qualified terminable interest property
RAP	rule against perpetuities
UITRS	Uniform Interagency Trust Rating System
UPIA	Uniform Principal and Income Act
USC	U.S. Code

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 American Taxpayer Relief Act of 2012
 Bank Secrecy Act of 1970
 Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010
 Gramm–Leach–Bliley Act of 1999
 Health Insurance Portability and Accountability Act of 1996
 Internal Revenue Code
 Investment Company Act of 1940
 Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot) Act of 2001

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12 CFR 9, “Fiduciary Activities of National Banks”
 12 CFR 150, “Fiduciary Powers of Federal Savings Associations”
 12 CFR1005, “Regulation E (Electronic Fund Transfer)”
 12 CFR 1016, “Privacy of Consumer Financial Information”
 26 CFR 1.67-4, “Costs Paid or Incurred by Estates or Non-Grantor Trusts”
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Comptroller’s Handbook

Asset Management series

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 “Large Bank Supervision”

Safety and Soundness series

“Insurance Activities”
“Internal and External Audits”
“Internal Control”

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