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A. INTRODUCTION

This appendix is intended to serve the examiner in gathering and recording information for the trust examination. Examiners have the discretion of using all, part, or none of these tools. Nevertheless, their use, particularly by inexperienced trust examiners, is encouraged.

The trust examination report is in narrative form. Its core pages only contain a few schedules. Normally, most other documents or information supporting report comments and conclusions should be placed in examination work papers. The information contained in this appendix offers examiners a means for both examining trust departments and documenting their work papers.

Uniform Interagency Trust Rating System (UITRS)

The UITRS was originally adopted in 1978 and was revised in 1998. The 1998 revision of the UITRS appears later in this appendix. It has been adopted by each of the Federal financial institution regulatory agencies. Both the Trust Manual and examination report have been designed around its structure. Examiners should review each of the five UITRS rating guidelines and summaries when assigning ratings and preparing comments for the report

Trust Examiner's First Day Letter

The first day letter requests management to provide specific information. A copy of this letter is reproduced in this appendix. Use of this letter is optional, and it may be modified by deleting or adding information at the discretion of the Examiner-in-Charge. In addition, the distribution of the letter should be coordinated with the state banking authority if that agency will participate in the examination. It should be prepared during the pre-examination work phase, and submitted to trust management, together with the "Trust Officer's Questionnaire" [FDIC Form 6350/11 (7-95)], prior to beginning the examination.

In the automated version of the first day letter, deletion of an entire question (from the beginning of the question # to the end of the question) will automatically renumber questions and repaginate the entire letter.

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B. UNIFORM INTERAGENCY TRUST RATING SYSTEM

The information that follows was published 10-13-98 in the Federal Register (63 FR 54711) and was distributed by the FDIC in FIL 115-98 dated 10-21-98.

Introduction

The Uniform Interagency Trust Rating System (UITRS) was adopted on September 21, 1978 by the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (FRB), and in 1988 by the Federal Home Loan Bank Board, predecessor agency to the Office of Thrift Supervision (OTS). Over the years, the UITRS has proven to be an effective internal supervisory tool for evaluating the fiduciary activities of financial institutions on a uniform basis and for identifying those institutions requiring special attention.

A number of changes have occurred in both the banking industry and the Federal supervisory agencies' policies and procedures which prompted a review and revision of the 1978 rating system. The revisions to the UITRS:

- Realign the UITRS rating definitions to bring them in line with the Uniform Financial Institutions Rating System (UFIRS).
- Reduce the component rating categories from six to five, combining the Account Administration and Conflicts of Interest components into a new Compliance component.
- Require Earnings to be rated only in institutions with more than $100 million in total trust assets, and in all non-deposit trust companies. An earnings rating is not required for the remaining institutions; however, each Federal supervisory agency has the option of requiring the earnings of these institutions to be rated using the alternate rating definitions where applicable.
- Explicitly refer to the quality of risk management processes in the management component, and the identification of risk elements within the composite and component rating definitions.

These revisions are intended to promote and complement efficient examination processes. The revisions update the rating system but retain its basic framework. Consequently, the revised rating system will not result in additional regulatory burden to institutions or require additional policies or processes.

The UITRS considers certain managerial, operational, financial and compliance factors that are common to all institutions with fiduciary activities. Under this system, the supervisory agencies endeavor to ensure that all institutions with fiduciary activities are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on those institutions exhibiting weaknesses in their fiduciary operations.

Overview

Under the UITRS, the fiduciary activities of financial institutions are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components address the following: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets.

Composite and component ratings are assigned based on a 1 to 5 numerical scale. A 1 is the highest rating and indicates the strongest performance and risk management practices and the least degree of supervisory concern. A 5 is the lowest rating and indicates the weakest performance and risk management practices and, therefore, the highest degree of supervisory concern. Evaluation of the composite and components considers the size and sophistication, the nature and complexity, and the risk profile of the institution's fiduciary activities.

The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall administration of the financial institution's fiduciary activities. Assigned composite and component ratings are disclosed to the institution's board of directors and senior management.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new fiduciary activities or products, is an important factor in evaluating an institution's overall fiduciary risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating.

The ability of management to identify, measure, monitor, and control the risks of its fiduciary operations is also taken into account when assigning each component rating. It is recognized, however, that appropriate management practices may vary considerably among financial institutions, depending on the size, complexity, and risk profiles of their fiduciary activities. For less complex institutions engaged solely in traditional fiduciary activities and whose directors and senior managers are actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. On the other hand, at more complex institutions, detailed and formal management systems and controls are needed to address a broader range of activities and to provide senior managers and directors with the information they need to supervise day-to-day activities.

All institutions are expected to properly manage their risks. For less complex institutions engaging in less risky activities, detailed or highly formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

The following two sections contain the composite rating definitions, and the descriptions and definitions for the five component ratings.

Composite Ratings

The five composite ratings are defined as follows:

Composite 1

Administration of fiduciary activities is sound in every respect. Generally all components are rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by management. The institution is in substantial compliance with fiduciary laws and regulations. Risk management practices are strong relative to the size, complexity, and risk profile of the institution's fiduciary activities. Fiduciary activities are conducted in accordance with sound fiduciary principles and give no cause for supervisory concern.

Composite 2

Administration of fiduciary activities is fundamentally sound. Generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Composite 3

Administration of fiduciary activities exhibits some degree of supervisory concern in one or more of the component areas. A combination of weaknesses exists that may range from moderate to severe; however, the magnitude of the deficiencies generally does not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Additionally, fiduciary activities may reveal some significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. While problems of relative significance may exist, they are not of such importance as to pose a threat to the trust beneficiaries generally, or to the soundness of the institution. The institution's fiduciary activities require more than normal supervision and may include formal or informal enforcement actions.

Composite 4

Fiduciary activities generally exhibit unsafe and unsound practices or conditions, resulting in unsatisfactory performance. The problems range from severe to critically deficient and may be centered around inexperienced or inattentive management, weak or dangerous operating practices, or an accumulation of unsatisfactory features of lesser importance. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the size, complexity, and risk profile of fiduciary activities. These problems pose a threat to the account beneficiaries generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine the public confidence in the institution. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5

Fiduciary activities are conducted in an extremely unsafe and unsound manner. Administration of fiduciary activities is critically deficient in numerous major respects, with problems resulting from incompetent or neglectful administration, flagrant and/or repeated disregard for laws and regulations, or a willful departure from sound fiduciary principles and practices. The volume and severity of problems are beyond management's ability or willingness to control or correct. Such conditions evidence a flagrant disregard for the interests of the beneficiaries and may pose a serious threat to the soundness of the institution. Continuous close supervisory attention is warranted and may include termination of the institution's fiduciary activities.

Component Ratings

Each of the component rating descriptions is divided into three sections: a narrative description of the component; a list of the principal factors used to evaluate that component; and a description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship among components. The listing of evaluation factors is in no particular order of importance.

Management

Description

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor and control the risks of an institution's fiduciary activities. It also reflects their ability to ensure that the institution's fiduciary activities are conducted in a safe and sound manner, and in compliance with applicable laws and regulations. Directors should provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures and practices are established and followed. Senior fiduciary management is responsible for developing and implementing policies, procedures and practices that translate the board's objectives and risk limits into prudent operating standards.

Depending on the nature and scope of an institution's fiduciary activities, management practices may need to address some or all of the following risks: operating or transaction, strategic, compliance, legal, credit, market, liquidity and other risks.[1] Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls that consider the size and complexity of the institution's fiduciary activities; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of fiduciary activities in which the institution is involved.

Factors Evaluated

The management rating is based upon an assessment of the capability and performance of management and the board of directors, including, but not limited to, the following evaluation factors:

- The level and quality of oversight and support of fiduciary activities by the board of directors and management, including committee structure and adequate documentation of committee actions.
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products.
- The adequacy of, and conformance with, appropriate internal policies, practices and controls addressing the operations and risks of significant fiduciary activities.
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and fiduciary risk profile.
- The overall level of compliance with laws, regulations, and sound fiduciary principles.
- Responsiveness to recommendations from auditors and regulatory authorities.
- Strategic planning for fiduciary products and services.
- The level of experience and competence of fiduciary management and staff, including issues relating to turnover and succession planning.
- The adequacy of insurance coverage.
- The availability of competent legal counsel.
- The extent and nature of pending litigation associated with fiduciary activities, and its potential impact on earnings, and capital.[1]
- The process for identifying and responding to fiduciary customer complaints.

[1] This sentence was shortened from the similar sentence in the UITRS.

Ratings

A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board are proactive, and have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material to the sound administration of fiduciary activities, and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution's fiduciary activities. The capabilities of management or the board of directors may be insufficient for the size, complexity, and risk profile of the institution's fiduciary activities. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the size, complexity, and risk profile of the institution's fiduciary activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to protect the assets of account beneficiaries and to prevent erosion of public confidence in the institution. Replacing or strengthening management or the board may be necessary.

A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution or its administration of fiduciary activities, and pose a threat to the safety of the assets of account beneficiaries. Replacing or strengthening management or the board of directors is necessary.

Operations, Internal Controls & Auditing

Description

This rating reflects the adequacy of the institution's fiduciary operating systems and internal controls in relation to the volume and character of business conducted. Audit coverage must assure the integrity of the financial records, the sufficiency of internal controls, and the adequacy of the compliance process.

The institution's fiduciary operating systems, internal controls, and audit function subject it primarily to transaction and compliance risk. Other risks including strategic, and financial risk may also be present.[2] The ability of management to identify, measure, monitor and control these risks is reflected in this rating.

Factors Evaluated

The operations, internal controls and auditing rating is based upon, but not limited to, an assessment of the following evaluation factors:

- Operations and Internal Controls, including the adequacy of:
  - Staff, facilities and operating systems;
  - Records, accounting and data processing systems (including controls over systems access and such accounting procedures as aging, investigation and disposition of items in suspense accounts);
  - Trading functions and securities lending activities;

[2] This sentence was shortened from the similar sentence in the UITRS.

  - Vault controls and securities movement;
  - Segregation of duties;
  - Controls over disbursements (checks or electronic) and unissued securities;
  - Controls over income processing activities;
  - Reconciliation processes (depository, cash, vault, sub-custodians, suspense accounts, etc.);
  - Disaster and/or business recovery programs;
  - Hold-mail procedures and controls over returned mail; and,
  - Investigation and proper escheatment of funds in dormant accounts.

- Auditing, including:

  - The independence, frequency, quality and scope of the internal and external fiduciary audit function relative to the volume, character and risk profile of the institution's fiduciary activities;
  - The volume and/or severity of internal control and audit exceptions and the extent to which these issues are tracked and resolved; and
  - The experience and competence of the audit staff.

<u>Ratings</u>

A rating of 1 indicates that operations, internal controls, and auditing are strong in relation to the volume and character of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled.

A rating of 2 indicates that operations, internal controls and auditing are satisfactory in relation to the volume and character of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates that operations, internal controls or auditing need improvement in relation to the volume and character of the institution's fiduciary activities. One or more of these areas are less than satisfactory. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

A rating of 4 indicates deficient operations, internal controls or audits. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and character of the institution's fiduciary activities. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action. Institutions with this level of deficiencies may make little provision for audits, or may evidence weak or potentially dangerous operating practices in combination with infrequent or inadequate audits.

A rating of 5 indicates critically deficient operations, internal controls or audits. Operating practices, with or without audits, pose a serious threat to the safety of assets of fiduciary accounts. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of the institution to continue engaging in fiduciary activities.

Earnings

<u>Description</u>

This rating reflects the profitability of an institution's fiduciary activities and its effect on the financial condition of the institution. The use and adequacy of budgets and earnings projections by functions, product lines and clients are reviewed and evaluated. Risk exposure that may lead to negative earnings is also evaluated.

An evaluation of earnings is required for all institutions with fiduciary activities. An assignment of an earnings rating, however, is required only for institutions that, at the time of the examination, have total trust assets of more than $100 million, or are a non-deposit trust company.

For institutions where the assignment of an Earnings rating is not required by the UITRS, the Federal supervisory agency has the option to assign an earnings rating using an alternate set of ratings. A rating will be assigned in accordance with implementing guidelines adopted by the supervisory agency. The definitions for the alternate ratings are included in the revised UITRS and may be found in the section immediately following the definitions for the required ratings.

Factors Evaluated

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

- The profitability of fiduciary activities in relation to the size and scope of those activities and to the overall business of the institution.
- The overall importance to the institution of offering fiduciary services to its customers and local community.
- The effectiveness of the institution's procedures for monitoring fiduciary activity income and expense relative to the size and scope of these activities and their relative importance to the institution, including the frequency and scope of profitability reviews and planning by the institution's board of directors or a committee thereof.

For those institutions for which a rating of earnings is mandatory, additional factors should include the following:

- The level and consistency of profitability, or the lack thereof, generated by the institution's fiduciary activities in relation to the volume and character of the institution's business.
- Dependence upon non-recurring fees and commissions, such as fees for court accounts.
- The effects of charge-offs or compromise actions.
- Unusual features regarding the composition of business and fee schedules.
- Accounting practices that contain practices such as (1) unusual methods of allocating direct and indirect expenses and overhead, or (2) unusual methods of allocating fiduciary income and expense where two or more fiduciary institutions within the same holding company family share fiduciary services and/or processing functions.
- The extent of management's use of budgets, projections and other cost analysis procedures.
- Methods used for directors' approval of financial budgets and/or projections.
- Management's attitude toward growth and new business development.
- New business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations, and an evaluation by management of risk potential inherent in new business areas.

Ratings

A rating of 1 indicates strong earnings. The institution consistently earns a rate of return on its fiduciary activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgment that future earnings prospects are favorable. In addition, management techniques for evaluating and monitoring earnings performance are fully adequate and there is appropriate oversight by the institution's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures. Methods used for reporting earnings information to the board of directors, or a committee thereof, are comprehensive.

A rating of 2 indicates satisfactory earnings. Although the earnings record may exhibit some weaknesses, earnings performance does not pose a risk to the overall institution nor to its ability to meet its fiduciary obligations. Generally, fiduciary earnings meet management targets and appear to be at least sustainable. Management processes for evaluating and monitoring earnings are generally sufficient in relationship to the size and risk of fiduciary activities that exist, and any deficiencies can be addressed in the normal course of business. A rating of 2 may also be assigned to institutions with a history of profitable operations if there are indications that management is engaging in activities with which it is not familiar, or where there may be inordinately high levels of risk present that have not been adequately evaluated. Alternatively, an institution with otherwise strong earnings performance may also be assigned a 2 rating if there are significant deficiencies in its methods used to monitor and evaluate earnings.

A rating of 3 indicates less than satisfactory earnings. Earnings are not commensurate with the risk associated with the fiduciary activities undertaken. Earnings may be erratic or exhibit downward trends, and future prospects are unfavorable. This rating may also be assigned if management processes for evaluating and monitoring earnings exhibit serious deficiencies, provided the deficiencies identified do not pose an immediate danger to either the overall financial condition of the institution or its ability to meet its fiduciary obligations.

A rating of 4 indicates earnings that are seriously deficient. Fiduciary activities have a significant adverse effect on the overall income of the institution and its ability to generate adequate capital to support the continued operation of its fiduciary activities. The institution is characterized by fiduciary earnings performance that is poor historically, or faces the prospect of significant losses in the future. Management processes for monitoring and evaluating earnings may be poor. The board of directors has not adopted appropriate measures to address significant deficiencies.

A rating of 5 indicates critically deficient earnings. In general, an institution with this rating is experiencing losses from fiduciary activities that have a significant negative impact on the overall institution, representing a distinct threat to its viability through the erosion of its capital. The board of directors has not implemented effective actions to address the situation.

Alternate Rating of Earnings

Description

Alternate ratings are assigned based on the level of implementation of four minimum standards by the board of directors and management. These standards are:

- Standard No.1 - The institution has reasonable methods for measuring income and expense commensurate with the volume and nature of the fiduciary services offered.
- Standard No. 2 - The level of profitability is reported to the board of directors, or a committee thereof, at least annually.
- Standard No.3 - The board of directors periodically determines that the continued offering of fiduciary services provides an essential service to the institution's customers or to the local community.
- Standard No. 4 - The board of directors, or a committee thereof, reviews the justification for the institution to continue to offer fiduciary services even if the institution does not earn sufficient income to cover the expenses of providing those services.

Ratings

A rating of 1 may be assigned where an institution has implemented all four minimum standards. If fiduciary earnings are lacking, management views this as a cost of doing business as a full service institution and believes that the negative effects of not offering fiduciary services are more significant than the expense of administrating those services.

A rating of 2 may be assigned where an institution has implemented, at a minimum, at least three of the four standards. This rating may be assigned if the institution is not generating positive earnings or where formal earnings information may not be available.

A rating of 3 may be assigned if the institution has implemented at least two of the four standards. While management may have attempted to identify and quantify other revenue to be earned by offering fiduciary services, it has decided that these services should be offered as a service to customers, even if they cannot be operated profitably.

A rating of 4 may be assigned if the institution has implemented only one of the four standards. Management has undertaken little or no effort to identify or quantify the collateral advantages, if any, to the institution from offering fiduciary services.

A rating of 5 may be assigned if the institution has implemented none of the standards.

Compliance

Description

This rating reflects an institution's overall compliance with applicable laws, regulations, accepted standards of fiduciary conduct, governing account instruments, duties associated with account administration, and internally established policies and procedures. This component specifically incorporates an assessment of a fiduciary's duty of undivided loyalty and compliance with applicable laws, regulations, and accepted standards of fiduciary conduct related to self-dealing and other conflicts of interest.

The compliance component includes reviewing and evaluating the adequacy and soundness of adopted policies, procedures, and practices generally, and as they relate to specific transactions and accounts. It also includes reviewing policies, procedures, and practices to evaluate the sensitivity of management and the board of directors to refrain from self-dealing, minimize potential conflicts of interest, and resolve actual conflict situations in favor of the fiduciary account beneficiaries.

Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific obligations. Risks associated with account administration include: failure to comply with applicable laws, regulations or terms of the governing instrument; inadequate account administration practices; and inexperienced management or inadequately trained staff. Risks associated with a fiduciary's duty of undivided loyalty generally stem from engaging in self-dealing or other conflict of interest transactions. An institution may be subject to compliance risk and strategic risk related to account administration and conflicts of interest activities. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. Policies, procedures and practices pertaining to account administration and conflicts of interest are evaluated in light of the size and character of an institution's fiduciary business.

Factors Evaluated

The compliance rating is based upon, but not limited to, an assessment of the following evaluation factors:

- Compliance with applicable federal and state statutes and regulations, including, but not limited to, federal and state fiduciary laws, the Employee Retirement Income Security Act of 1974, federal and state securities laws, state investment standards, state principal and income acts, and state probate codes;
- Compliance with the terms of governing instruments;
- The adequacy of overall policies, practices, and procedures governing compliance, considering the size, complexity, and risk profile of the institution's fiduciary activities;
- The adequacy of policies and procedures addressing account administration;
- The adequacy of policies and procedures addressing conflicts of interest, including those designed to prevent the improper use of "material inside information";
- The effectiveness of systems and controls in place to identify actual and potential conflicts of interest;
- The adequacy of securities trading policies and practices relating to the allocation of brokerage business, the payment of services with "soft dollars" and the combining, crossing, and timing of trades;
- The extent and permissibility of transactions with related parties, including, but not limited to, the volume of related commercial and fiduciary relationships and holdings of corporations in which directors, officers, or employees of the institution may be interested;
- The decision making process used to accept, review, and terminate accounts; and,
- The decision making process related to account administration duties, including cash balances, overdrafts, and discretionary distributions.

Ratings

A rating of 1 indicates strong compliance policies, procedures and practices. Policies and procedures covering conflicts of interest and account administration are appropriate in relation to the size and complexity of the institution's fiduciary activities. Accounts are administered in accordance with governing instruments, applicable laws and regulations, sound fiduciary principles, and internal policies and procedures. Any violations are isolated, technical in nature and easily correctable. All significant risks are consistently and effectively identified, measured, monitored and controlled.

A rating of 2 indicates fundamentally sound compliance policies, procedures and practices in relation to the size and complexity of the institution's fiduciary activities. Account administration may be flawed by moderate weaknesses in policies, procedures or practices. Management's practices indicate a determination to minimize the instances of conflicts of interest. Fiduciary activities are conducted in substantial compliance with laws and regulations, and any violations are generally technical in nature. Management corrects violations in a timely manner and without loss to fiduciary accounts. Significant risks are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates compliance practices that are less than satisfactory in relation to the size and complexity of the institution's fiduciary activities. Policies, procedures and controls have not proven effective and require strengthening. Fiduciary activities may be in substantial noncompliance with laws, regulations or governing instruments, but losses are no worse than minimal.

While management may have the ability to achieve compliance, the number of violations that exist, or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risk management practices generally need improvement.

A rating of 4 indicates an institution with deficient compliance practices in relation to the size and complexity of its fiduciary activities. Account administration is notably deficient. The institution makes little or no effort to minimize potential conflicts or refrain from self-dealing, and is confronted with a considerable number of potential or actual conflicts. Numerous substantive and technical violations of laws and regulations exist and many may remain uncorrected from previous examinations.

Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively administer fiduciary activities. The level of compliance problems is significant and, if left unchecked, may subject the institution to monetary losses .[3] Risks are inadequately identified, measured, monitored and controlled.

A rating of 5 indicates critically deficient compliance practices. Account administration is critically deficient or incompetent and there is a flagrant disregard for the terms of the governing instruments and interests of account beneficiaries. The institution frequently engages in transactions that compromise its fundamental duty of undivided loyalty to account beneficiaries. There are flagrant or repeated violations of laws and regulations and significant departures from sound fiduciary principles. Management is unwilling or unable to operate within the scope of laws and regulations or within the terms of governing instruments and efforts to obtain voluntary compliance have been unsuccessful. The severity of noncompliance presents an imminent monetary threat to account beneficiaries and creates significant legal and financial exposure to the institution. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of management to continue engaging in fiduciary activities.

Asset Management

Description

This rating reflects the risks associated with managing the assets (including cash) of others. Prudent portfolio management is based on an assessment of the needs and objectives of each account or portfolio. An evaluation of asset management should consider the adequacy of processes related to the investment of all discretionary accounts and portfolios, including collective investment funds, proprietary mutual funds, and investment advisory arrangements.

The institution's asset management activities subject it to compliance and strategic risks.[3] In addition, each individual account or portfolio managed by the institution is subject to financial risks such as market, credit, liquidity, and interest rate risk, as well as transaction and compliance risk. The ability of management to identify, measure, monitor and control these risks is reflected in this rating.

Factors Evaluated

The asset management rating is based upon, but not limited to, an assessment of the following evaluation factors:

- The adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the institution's fiduciary activities.
- The decision-making processes used for selection, retention, and preservation of discretionary assets including adequacy of documentation, committee review and approval, and a system to review and approve exceptions.
- The use of quantitative tools to measure the various financial risks in investment accounts and portfolios.
- The existence of policies and procedures addressing the use of derivatives or other complex investment products.
- The adequacy of procedures related to the purchase or retention of miscellaneous assets including real estate, notes, closely held companies, limited partnerships, mineral interests, insurance, and other unique assets.
- The extent and adequacy of periodic reviews of investment performance, taking into consideration the needs and objectives of each account or portfolio.
- The monitoring of changes in the composition of fiduciary assets for trends and related risk exposure.

[3] This sentence was shortened from the similar sentence in the UITRS.

- The quality of investment research used in the decision-making process and documentation of the research.
- The due diligence process for evaluating investment advice received from vendors and/or brokers (including approved or focus lists of securities).
- The due diligence process for reviewing and approving brokers and/or counter parties used by the institution.

This rating may not be applicable for some institutions because their operations do not include activities involving the management of any discretionary assets. Functions of this type would include, but not necessarily be limited to, directed agency relationships, securities clearing, non-fiduciary custody relationships, transfer agent and registrar activities. In institutions of this type, the rating for Asset Management may be omitted by the examiner in accordance with the examining agency's implementing guidelines. However, this component should be assigned when the institution provides investment advice, even though it does not have discretion over the account assets. An example of this type of activity would be where the institution selects or recommends the menu of mutual funds offered to participant directed 401(k) plans.

Ratings

A rating of 1 indicates strong asset management practices. Identified weaknesses are minor in nature. Risk exposure is modest in relation to management's abilities and the size and complexity of the assets managed.

A rating of 2 indicates satisfactory asset management practices. Moderate weaknesses are present and are well within management's ability and willingness to correct. Risk exposure is commensurate with management's abilities and the size and complexity of the assets managed. Supervisory response is limited.

A rating of 3 indicates that asset management practices are less than satisfactory in relation to the size and complexity of the assets managed. Weaknesses may range from moderate to severe; however, they are not of such significance as to generally pose a threat to the interests of account beneficiaries. Asset management and risk management practices generally need to be improved. An elevated level of supervision is normally required.

A rating of 4 indicates deficient asset management practices in relation to the size and complexity of the assets managed. The levels of risk are significant and inadequately controlled. The problems pose a threat to account beneficiaries generally, and if left unchecked, may subject the institution to losses.[4]

A rating of 5 represents critically deficient asset management practices and a flagrant disregard of fiduciary duties. These practices jeopardize the interests of account beneficiaries, subject the institution to losses, and may pose a threat to the soundness of the institution.

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C. TRUST EXAMINER'S FIRST DAY LETTER

NAME OF INSTITUTION:

DATE OF EXAMINATION:

PRIOR EXAMINATION DATE:

EXAMINER-IN-CHARGE:

THE FOLLOWING ITEMS OR MATERIALS ARE REQUESTED TO EXPEDITE THE EXAMINATION OF YOUR INSTITUTION'S TRUST ACTIVITIES. THE ACCURACY AND TIMELINES OF DATA PROVIDED ARE VITAL TO THE SUCCESSFUL EXAMINATION OF YOUR INSTITUTION. PLEASE HAVE THE FOLLOWING AVAILABLE ON (INSERT DATE).

[4] This sentence was shortened from the similar sentence in the UITRS.

Please provide the following information as of (Insert Date).

If information requested is not applicable, please indicate with a NA.

Feel free to use your software provider's audit package to provide the requested information.

1. Regulatory and Legal Information

- Trust Officer's Questionnaire (form provided), certified by the senior trust officer or other senior bank officer as of (Insert Date).

- Current trust department statement of assets and liabilities or trust department statement of condition.

- Information on pending fiduciary matters describing any threatened and/or pending litigation against the bank in connection with its fiduciary activities. Please include the following information:

  a. identification of accounts concerned;

  b. nature of, or basis for, the litigation;

  c. amount involved;

  d. present status of the action; and

  e. statement as to the probable outcome of the action, together with its cost to the bank.

- Indicate if legal counsel is retained on an on-going basis to advise the Board of Directors, the trust committee(s), and the trust officer(s) on legal matters pertaining to fiduciary administration.

- Indicate if written legal opinions are obtained and filed in connection with legal questions arising during the course of an account's administration.

- Provide a copy of any communication with the Department of Labor, Securities and Exchange Commission, Internal Revenue Service, or National Association of Securities Dealers for the bank, its subsidiaries or affiliates since the previous examination.

- Provide a copy of the customer complaint log since the last examination. If a complaint log is not maintained, provide a list of customer complaints filed since the last examination including the following information:

  a. name of complainant;

  b. date of complaint;

  c. description of the complaint

  d. resolution of the complaint

2. Organization

- Provide an organization chart of the department.

- Provide a copy of the department's current strategic plan, marketing plan, and budget.

- Provide a list of all bank subsidiaries and affiliates, together with a brief synopsis of capitalization and activities engaged in by the subsidiary or affiliate. (Annual report will suffice.)

- If there has been any acquisition of, or mergers with, other trust departments since the last examination, please provide the following:

  a. method for establishing the purchase price;

  b. extent of due diligence performed on trust accounts before acquisition or merger; and

  c. date of regulatory approval received from state or FDIC, if required.

- Make available the Minutes of the Board of Directors and/or trust committee(s) pertaining to trust activities since (Insert Date).

- Provide the following information with respect to each committee supervising trust (and transfer agent) activities:

  a. name of committee;

  b. principal functions of the committee;

  c. number of members authorized by the Board of Directors;

  d. annual fees paid, if any;

  e. attendance fee paid members;

  f. list of committee members;

  g. year of birth of committee members;

  h. principal business interests, or occupation of committee members;

  i. salary of committee members who are also officers of the bank.

- Provide the following information with respect to principal officers:

  a. name and title;

  b. principal duties;

  c. year of birth;

  d. percent of time devoted to the trust institution;

  e. current salary and last year's bonus;

  f. if hired since the last examination, please provide a résumé of the officer or list education and degrees awarded, work history, names of other financial institutions where employed, title, and principal duties.

  g. proof of quarterly investment reports completed by applicable department/bank personnel since the previous examination pursuant to Section 344.9(d) of the FDIC's Rules and Regulations.

- Provide aggregate number of junior officers and the total amount of their salaries.

- Provide aggregate number of staff other than officers and the total amount of their salaries.

- With respect to directors, officers, and employees of the bank, provide the following:

  a. a list of their direct obligations held in any account, indicating whether any such items are receiving special or preferential treatment, e.g., rates of interest, etc;

  b. a list of holdings of stock and/or obligations of their corporations held in any account; and

  c. a list of fiduciary accounts for which they serve as co-fiduciary; a list of fiduciary accounts for which they have any interest as either a donor or beneficiary (exclude interests in own bank employee benefit plans).

- Provide a summary of insurance policies currently carried to cover fiduciary activities, including coverage for real estate properties held in trust.

3. General Account Administration

- Make available a copy of the department's written policies and procedures. Please indicate the date on which the Board of Directors approved the policies.

- Provide a copy of the bank and/or department's privacy policy and customer disclosures.

- Provide a list of all accounts (e.g., account trial balance), listing for each: (Note: for items f, g and h please identify if shown at "book" or "market" value)

  a. account title and number;

  b. account officer;

  c. investment officer;

  d. principal cash;

  e. income cash;

  f. invested principal (summary total per account, not detail of assets or tax lots unless requested);

  g. invested income (summary total per account, not detail of asset or tax lots unless requested); and

  h. summary totals for cash and assets of all accounts (by major appointment category).

- Provide a summary listing of assets by type and CUSIP number and the aggregate number of units held. The report should also provide the total "book" and "market" value of each asset.

- Provide a copy of the account codes used to read the reports requested in items 21 and 22.

- Provide a list of liabilities within accounts, such as borrowings, etc. Please indicate the dollar value of assets pledged by the account, if any, to collateralize such liabilities.

- Provide a list of terminated accounts that have not been distributed, including the reasons therefore.

- Provide a list of watch-listed accounts.

4. Operations/Audits

- Provide copies of following reports, as they pertain to overall trust activity, since the previous examination.

  a. internal audits, including scope of account review;

  b. external audits' including scope of account review;

  c. FDICIA Risk matrix, if applicable; and

  d. SAS 70, if applicable.

- Provide the most recent reconcilement(s) and supporting documentation of the department's.

  a. demand deposit account(s);

  b. safekeeping and/or safekeeping exception report;

  c. brokerage accounts;

  d. suspense accounts;

  e. house accounts; and

  f. failed trades.

- Provide a list of bank assets (indicate par and market values of each security):

  a. pledged with state authorities;

  b. pledged with the trust department; or

  c. otherwise segregated and earmarked to secure trust activities or uninvested trust cash.

- Provide copies of the last year-end Call Report and the work papers for the preparation of Schedule RC-T. If the institution files Schedule RC-T data on a quarterly basis, also provide the last quarter's Call Report and the work papers for the preparation of Schedule RC-T.

- Provide reports used to review the following:

  a. overdrafts;

  b. cash equivalent balances;

  c. large cash balances; and

  d. other cash balances available for investment.

- Provide a listing of outside service providers and have copies of their contracts available for review. Examples include software service providers, pricing services, record keepers, proxy voting services, and so on.

- Provide the date of the most recent business resumption (contingency) plan and the results of the last contingency plan test.

- Please provide summary information on the following trust activities, if applicable

  a. electronic banking, including the use of web sites. Please provide web site addresses, if any;

  b. new trust products developed since last examination.

5. Investments

- Provide a list of accounts with discretionary investment authority that hold own-bank or affiliated financial institution interest-bearing deposits. Please indicate interest rates paid and maturity. Report own bank and affiliated-institution deposits separately. Also report money market deposits and certificates of deposit separately.

- Provide a copy of the following:

  a. a list of approved investments (buy/sell list), including mutual funds and cash equivalents;

  b. details of any asset allocation models used to select investments; and

  c. investments on any internal watch list.

- Provide a copy of the last Rule 13f-1 quarterly report submitted to the Securities and Exchange Commission pursuant to Regulation 240.13f-1, if applicable. (Institutional investment managers that use the United States mail, or other means or instrumentality of interstate commerce, in the course of their business and that exercise investment discretion over $100 million or more in Section 13(f) securities must file Form 13F)

- Provide the following information on broker-relationships:

  a. a list of brokers utilized and broker fees and commissions paid during the last three calendar years and year-to-date;

  b. a description of the procedures followed regarding the placement of brokerage business for fiduciary accounts;

  c. a description of the procedures followed to ensure that the most favorable execution and commission rates are obtained; and

  d. the last formal analysis of broker relationships.

- Describe all payments, since the last examination, of soft dollars to securities brokers and dealers. Please state if written policies have been adopted to ensure compliance with the safe harbor provisions of Section 28(e) of the Securities Exchange Act of 1934.

- List appointments where the institution has sole or joint responsibility for assets that are not in its possession, or those over which accounting control has not been established.

- If the bank operates common or collective investment funds or other pooled investment vehicles, provide for each fund:

  a. if a new fund has been established or a previously established fund has been closed since the last FDIC examination, the rationale and analysis supporting the decision to open or close the fund;

  b. a copy of any amendments to governing instruments since the previous examination;

c. a list of all participants, providing detail and summary totals for: number of participants, units held, and cost of units held;

d. a copy of the last valuation for each fund;

e. a copy of each fund's last annual report; and

f. a list of assets held by each fund as of the last valuation date.

- Provide a list of voting securities held in discretionary fiduciary accounts where the department holds, in the aggregate:

  a. 5% or more of the outstanding class of securities (if securities are registered pursuant to Section 12 of the Securities Exchange Act of 1934); and

  b. 25% or more of the outstanding class of securities, if not registered under Section 12.

- Provide the following with respect to own bank, parent, or affiliate stock and/or obligations:

  a. a list of discretionary fiduciary accounts that hold such securities and/or obligations, together with the number of shares and/or face value of obligations held (*include all shares held in any account, including custodial and safekeeping, if management holds or exercises voting authority*);

  b. total number of shares held in all trust department accounts that were voted by management at the last stockholders meeting;

  c. total number of shares held in discretionary fiduciary accounts that were voted by others;

  d. total number of shares voted at the last stockholders meeting;

  e. total number of shares outstanding at the last stockholders meeting, and currently outstanding;

  f. date of the last review of such holdings, if reviewed in the aggregate, by the trust committee;

  g. if the stock is publicly traded, provide the date of the last activity in such stock, total shares traded, and the closing price;

  h. if the stock is not publicly traded, provide the date of the last sale of such stock, the number of shares sold, and the execution price; and

  i. current dividend (state whether annual or other basis is being quoted).

- If the department does not have written policies on the following, identify current practices with respect to these areas:

  a. purchase and/or retention of own bank, parent and/or affiliate stock and obligations; and

  b. voting of own bank, parent, and/or affiliate stock held in any account.

- Describe the department's policies regarding the voting of stock held in accounts, including common and collective investment funds. Indicate whether the department has solicited written instructions from beneficial owners as to the forwarding of proxy material and voting of securities held on their behalf.

- Describe any receipt of fees from 12b-1, shareholder servicing, record keeping or any other arrangements with mutual fund companies. Please provide copies of any written solicitations for customer approval to use their accounts in such arrangements.

- Describe any receipt of sweep fees. Please provide copies of any written solicitations for customer approval to use their accounts in such arrangements.

- Provide the following information on real estate holdings within trust accounts:

  a. a list of mortgaged property on which payments of principal, interest, or taxes are delinquent;

  b. a list of any real property held by accounts on which taxes are delinquent;

  c. a list of expired property insurance on mortgaged property, or other real property held as assets, unless liability thereon is covered by blanket insurance;

  d. a statement of the department's policy/practice concerning employment of agents in the operation or management of real estate owned in fiduciary accounts. If such agents make cash collections, describe procedures for monitoring the receipt of the funds.

  e. a list of pending foreclosures involving mortgages held as trust assets;

  f. a list of real estate held by accounts on which there exist delinquencies in rental income; and

  g. a list of real property held in any fiduciary account, that is leased to the bank, an affiliate, or to any director, officer, or employee.

6. Earnings

- Provide the trust department income (by product line, if available) and expenses on a calendar basis for the last 3 years and for the year-to-date. Also, include information on surcharges, losses, fees waived, charge-offs, and recoveries. Items of less than $100 may be grouped.

- Provide a list of accounts on which no fees or commissions are charged, including the reasons therefore.

- Provide a list of client fees billed but unpaid for six months or more.

- Provide a copy of the current fee schedule. Describe briefly the procedures for approving exceptions to the schedule.

- Describe the department's new business development efforts, including types of business solicited, minimum dollar size of accounts that will be accepted, nature of new business efforts, competition, market potential and projected growth.

7. Personal Trusts and Estates

- Provide a list of accounts for which accountings have not been filed with courts, beneficiaries, or other parties holding authority to release the bank from liability.

- Provide a list of estates that remain open for a period exceeding 18 months and where the institution has not filed an accounting.

8. Bank Sponsored Employee Benefit Plans

- With respect to own bank, holding company, or subsidiary employee benefit plans carried within the department, please supply:

  a. the plan document and trust agreements, if new since the previous examination;

  b. amendments made to the plan since the last examination;

  c. the Form 5500 filed since the previous examination;

  d. the last year-end and most recent listing of assets;

  e. all audits conducted since the last examination;

  f. trustee and/or plan administrator committee minutes;

  g. information packet, initial and continuing education, provided to participants; and

  h. last investment analysis on reasonableness of available investment options.

9. Corporate Trust Accounts

- Provide a list of transfer agent and/or registrar appointments.

- Provide a list of transfer agent and/or registrar accounts that are out of proof.

- List corporate trusteeship appointments. Please provide:

  a. face value of bonds originally issued;

  b. face value currently outstanding; and

  c. whether any appointment is subject to the Trust Indenture Act of 1939.

- Provide a list of all corporate trusteeships that are in default. Please indicate:

  a. the date and nature of default;

  b. actions taken by the institution;

  c. current status; and

  d. face value of bonds outstanding.

- Provide a list of corporate trusteeships that are receiving special administrative attention, and those in which obligors have not complied with indenture requirements.

10. Other Activities

- If the department engages in customer securities lending activities, please provide the following:

  a. a copy of the securities lending agreement executed with trust department customers and counterparties; and

  b. a copy of the department's securities lending confirmation.

- If the bank as principal or agent (a) underwrites, trades, or deals in municipal securities, or (b) provides investment or consultant services to issuers or purchasers of municipal securities, please provide the name of the individual supervising this activity.

- If the bank as principal or agent trades or deals in U.S. Treasury securities, please provide the name of the individual supervising this activity.

- If the bank or an affiliate conducts securities brokerage activities, please provide the name of the individual supervising this activity.

- If the bank, any subsidiary, or any affiliate serves as investment advisor or investment manager for any mutual fund, or acts as sponsor, distributor, or custodian for any outside, own bank, subsidiary or affiliate operated mutual fund, please provide the name of the individual supervising this activity.

- If the bank as principal or agent sells securities under agreement to repurchase, or purchases securities under agreement to resell (whether or not the trust department participates in the program on behalf of its customers), please provide the name of the individual supervising this activity.